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Financial Statement Audit

Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003

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Australian National
Audit Office

Canberra ACT
30 June 2003

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations and inspections of the accounts and records of major Commonwealth entities as part of the audits of their financial statements in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of these audits and the accompanying brochure. The report is titled *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003.*

Following its presentation and receipt, 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

AAO	Administrative Arrangement Orders
AAS	Australian Accounting Standard
ACA	ANAO Assurance Control and Assessment Report
AFP	Australian Federal Police
APS	Australian Public Service
AUS	Australian Auditing Standard
ANAO	Australian National Audit Office
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CEIs	Chief Executive Instructions
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CobiT	Control Objectives for Information Related Technology Model
FMA Act	*Financial Management and Accountability Act 1997*
FMIS	Financial Management Information System
FMOs	Finance Minister's Orders
HRMIS	Human Resources Management Information System
IT	Information Technology
KPI	Key Performance Indicator
RBA	Reserve Bank of Australia

Foreword

Following the aftermath of recent Australian and overseas corporate failures, both the Commonwealth Government and various regulatory bodies have, over the last 12 months, sought to investigate the underlying reasons for the breakdowns in aspects of corporate governance which resulted in a number of corporate failures.

In addition to the conduct of a Royal Commission[1], a number of national and international industry and regulatory bodies have published guidelines[2] relating to corporate governance in a move to strengthen, among other things, the level of internal control and accountability within companies.

In the last decade, agencies in the Australian Public Service (APS) have put into place many of the elements of good corporate governance which are now being endorsed elsewhere as better practice. Recent events in the corporate sector have reinforced the focus on public sector governance, particularly in achieving better integration in the various elements of the governance framework for improved conformance and performance.

In 1999, the Australian National Audit Office (ANAO) produced a Principles and Better Practices Discussion Paper entitled "Corporate Governance in Commonwealth Authorities and Companies"[3], following on from a similarly titled Paper in 1997 for Budget funded Agencies.[4]

This later Paper provided examples for government entities of good corporate governance arrangements including:

- preparation of corporate objectives, business plans and strategy documents;
- setting up an independent audit committee and clearly documenting its roles and responsibilities;
- preparing risk management and fraud control plans;
- identifying entity stakeholders and determining their expectations regarding the entity's operations; and

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1 HIH Royal Commission.

2 New York Stock Exchange. *Report of the NYSE Corporate Accountability and Listing Standards Committee* June 2002. Australian Stock Exchange. *Principles of Good Corporate Governance and Best Practice Recommendations,* March 2003.

3 *ANAO Corporate Governance in Commonwealth Authorities and Companies.* Principles and Better Practices, Discussion Paper. Canberra, May 1999.

4 ANAO *Applying Principles and Practice of Corporate Governance in Budget Funded Agencies.* Canberra, July 1997.

- articulating the values and code of ethics applicable to the operation of the entity.

The ANAO is proposing to issue a new Guide on Public Sector Governance in July 2003 dealing with the key elements, processes and principles of governance. While the principles of corporate governance are perhaps seen to be more relevant now than they were four years ago, the real challenge for APS management is not simply to put the various elements of corporate governance in place, but to ensure that those elements are implemented effectively, well understood, applied properly, and fully integrated as a vital element of the 'culture' of each entity. This requires leadership and 'tone at the top', as many experienced corporate commentators have suggested.

A fundamental factor forming the cornerstone of management's ability to implement good governance arrangements, is the importance of having in place an effective control structure that underpins reliable financial reporting and analysis. An internal control structure is integral to ensuring appropriate attention is directed at both performance and conformance issues and that there is alignment in key business objectives and the control environment, the security and utility of information systems, the adequacy of specific control processes and the key imperatives of financial management and reporting.

This report, prepared as part of the audits of financial statements of major Commonwealth entities, primarily continues the ANAO's focus on the importance of the internal control structure within entities, as a fundamental component of corporate governance. While this is the major element of ensuring conformance and, as such, is essential for accountability, an appropriate balance has to be struck at points in time and over time between the imperatives of conformance and performance. Put simply, entities need to be concerned not only with achieving the required results but also about how they are achieved.

The ANAO's audit focus is directed at the significant risk, control and related management issues within operating and accounting processes and financial systems, that support the financial reporting processes of major Commonwealth entities for the year ending 30 June 2003. The findings in this report are based on the results of the ANAO's interim audit activities conducted over the first nine months of this financial year. A second report will follow in December 2003 on completion of the financial statement audits for this year.

The ANAO provides entities' management with a formal written assessment of findings arising out of its interim audits, and recommends ways to ensure the adequacy of their internal control structure, including effective risk management, and specific internal controls in business and accounting processes and financial systems. What entities actually do is a matter for their Chief Executive Officer and/or Boards.

In addition to providing an updated assessment of the internal control environment within entities examined, this year's report seeks to extend the ANAO's assessment of the financial well-being of the Commonwealth by providing observations in regard to strategic issues and influences which are, or will be in future, likely to affect the overall financial framework. In this way, we expect to assist improvement in financial statement reporting and the use of financial information.

In particular, Chapter 1 of this report offers a commentary on various issues which, in the broader context of the impact caused by the move to a full accrual based financial reporting system, are likely to have a significant influence on the implementation and evolution of efficient and effective financial management policies and procedures within the APS.

I would like to again acknowledge the professionalism and commitment of my staff in undertaking the audit work which culminated in this report and in reporting back to the individual organisations concerned. I also record our appreciation for the cooperation of chief finance officers (CFOs) and other relevant entity staff in preparing this report. Their combined efforts enabled the tabling of this report for the information of the Parliament in a timely manner.

P.J. Barrett
Auditor-General
30 June 2003

Summary

Summary

Introduction

1. This report updates the ANAO's assessment of audit findings relating to major entity internal control structures, including governance arrangements, information systems and control procedures through to March 2003. The findings summarised in this report arose from the interim phase of the financial statement audits of major Commonwealth entities for 2002–2003. Examinations of such issues are designed to assess the reliance that can be placed on control structures to produce complete, accurate and valid information for financial reporting purposes.

2. This year's report also considers a number of strategic issues which will potentially have a significant influence over the continuing evolution of better practice financial management practices in the public sector (Chapter 1). These strategic issues include:

- the need for financial information to become more integrated into the longer-term decision-making and resource allocation considerations of entity managers;
- the need for greater focus on linking risk assessment and its management to the potential financial impacts arising out of those risks;
- the need to ensure that the governance frameworks which have been set up are effectively integrated into the 'culture' of entities; and
- the achievement of an Australian accounting standard for a single set of Government reports which are auditable, comparable between juristictions and in which the outcome statements are directly comparable with the relevant budget statements.[5]

3. A second report will be issued in December 2003 following completion of the financial statement audits of entities. The ANAO will also report, at that time, on any additional operational and financial management issues arising out of the final audits and their relationship to internal control structures, including risk management and fraud control.

4. This report also provides a summary of the financial, accounting and Information Technology (IT) control processes adopted by entities. It includes an update on the broader corporate governance issues that impact on financial management and reporting. Prior year audit findings outlined in ANAO Audit

[5] AASB Implementation Plan for FRC strategic direction on GAAP/GFS.

Reports No.67 of 2001–2002[6] and No.25 of 2002–2003[7], noted that continued progress was achieved in the financial year ended 30 June 2002 in resolving internal control and financial reporting issues raised in previous years. It was also concluded, however, that improvements were still required in most entities to assist the understanding of accrual accounting, the timeliness and consistency of financial reporting, the analysis of costs and overheads, and the performance measurement processes and analyses.

5. Audit findings have been classified into three groups:

- those concerned with entities' internal control environment;
- their IT systems; and
- their specific control procedures over significant business and accounting processes.

These are summarised below.

Internal control environment

6. As part of the financial statement audit process, the ANAO assesses whether an entity's internal control environment comprises measures that contribute positively to sound corporate governance. The measures should mitigate identified risks and reflect the specific governance requirements of each entity. For financial reporting purposes, they will normally include:

- a senior executive group which meets regularly;
- an audit committee which comprises appropriately skilled external members and meets on a regular basis;
- an effective internal audit function;
- a current corporate plan, business risk assessment and management plan, and fraud control plan;
- clearly specified systems of authorisation, recording and procedures;
- sound organisational business practices;
- financial and accounting skills commensurate with responsibilities; and
- a timely financial reporting regime.

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6 ANAO Audit Report No.67 2001–2002 *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2002,* ANAO, Canberra, June 2002.

7 ANAO Audit Report No.25 2002–2003 *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002*, ANAO, Canberra, December 2002.

7. In last year's corresponding report, it was noted that improvements were required by some entities in a number of these areas. Entities generally acknowledged that enhancements were necessary in areas such as:

- increased risk awareness assessment, and better management, including the use of performance management tools such as data metrics to monitor trends in risk;
- enhancing the quality and presentation of monthly financial reporting;
- integrating financial and non-financial data as part of the development of credible performance measurement frameworks; and
- improving the capacity of internal audit functions to deliver a blend of compliance, performance and risk-based audit services.

8. ANAO audit observations this year indicate that progress has been achieved across most entities in these areas. However, in some cases, further progress and refinement are still required. This is particularly the case in respect of expanding the level of reporting of non-financial performance measures and reviewing the effectiveness and efficiency of entity internal audit functions.

9. In addition, the review of the underlying causes of corporate failures that occurred in Australia and overseas in recent times has continued to increase the focus on sound corporate governance within the APS:

(i) first, at a **conformance** level, by:

- ensuring that the audit committee comprises at least one independent member who has relevant subject matter expertise and financial acumen; and
- having the audit committee chaired by a professional executive independent of the entity's management structure; and

(ii) second, at a **performance** level, by:

- ensuring entity financial capability is aligned with and complements both its strategic goals and long-term organisational requirements;
- continuing risk evaluation, assessment and treatment across strategic and operational processes to integrate more fully a risk management culture within the entity. A particular emphasis arising from this year's review is the need for instigation of arrangements for the ongoing identification and analysis of risks within the operation, i.e. not just as part of an annual review; and
- continuing emphasis on enhancing the various components of sound business practices.

10. These are areas where most Commonwealth entities would benefit from a review of their existing internal control framework and corporate governance arrangements. The ANAO will look to examine the issues in these particular areas and monitor developments over the coming year.

Information technology systems

11. The Commonwealth Government has a significant investment in information and communications technology (ICT). As noted in Chapter 4 of this report, the Commonwealth Government spent an estimated $2.04 billion during 1999–2000 on ICT.

12. New technologies have also introduced increased complexity, speed, interconnectivity and dependence on information systems within the IT environment, which involve substantial costs and increased risks, but also provide the scope for improved productivity and better service.

13. Areas noted in last year's corresponding report, where control improvements were required in relation to information systems, included:

- greater levels of integration of IT into the corporate planning process by integrating IT planning with strategic and risk management planning;
- refining IT project management policies and procedures over the implementation of IT solutions;
- expanding the reporting of IT organisational monitoring to include the use of performance management and IT capacity;
- continued development and refining of business continuity and disaster recovery plans; and
- revising and refining IT security strategies and policies.

14. Overall, the results of audit testing indicate that most entities have taken steps to address the issues raised in last year's corresponding report, but to varying degrees.

15. Opportunities exist for most entities in the coming year to further improve their IT processes which will continue to assist in better aligning the IT corporate governance framework with business objectives. The following are areas where most entities could continue to improve:

- tightening of information security across the entity and within key business applications;
- actively managing the security requirements specified in their outsourcing contracts;

- gaining a better understanding of their specific business continuity risks and business impact, assigning operational responsibility, establishing quality business continuity plans and disaster recovery plans and performing followup reporting on progress; and
- maintaining the responsibility for business continuity planning and establishing more clearly defined relationships with their outsourcers to ensure they are both aware of the business continuity risks.

16. The amount of effort necessary to improve further is dependent upon an assessment of the risk versus return equation on the level of investment required, and the extent to which an entity is dependent on IT to achieve its corporate goals.

17. As there is a fundamental dependency, or at least a significant interdependency in the IT area, an important and practical consideration will be the need to balance affordable information security against expected costs.

18. The ANAO will focus its attention on the above areas in the next financial year.

Control procedures

19. An entity's system of internal control includes the procedures established to provide reasonable assurance that operational and administrative objectives and goals are achieved. Internal control procedures within significant operational and accounting processes and financial systems are examined as part of the audit of an entity's financial statements. In most entities, key areas covered in the interim phase of the audit will include:

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

20. Some entities continue to experience difficulty with a number of control processes specific to their operations covering for example, timely completion and review of reconciliations, segregation of duties, inappropriate delegations, incorrect classification of general ledger expenses, monitoring of grant and funding agreements, reconciliation of program payments, poor documentation relating to asset acquisitions and disposals, and the timely recording of those asset movements.

21. Reconciliation of the asset register to the financial management information system (FMIS) is an ongoing issue. In addition, a persistent reconciliation issue, which was noted in last year's corresponding report, continues to occur in a number of entities. This relates to the need to reconcile payroll and leave costs recorded in human resources management information systems (HRMIS) with balances recorded in the general ledger of the FMIS. The ANAO continues to reinforce the importance of this reconciliation process given the significance of personnel costs to entities and the potential impact for errors in financial reporting.

22. The ANAO also notes the increasing incidence of entities undertaking significant in-house software developments and the consequential issues surrounding the proper distinction between the capitalised and operating expenditures. As well, there are issues related to intellectual property.

23. The ANAO will continue to review the above issues in order to assess improvements over the coming year.

Key findings

24. The ANAO rates its findings according to a risk scale. Audit findings which pose a significant business or financial risk to the entity and which must be addressed as a matter of urgency, are rated as 'A'. Findings that pose a moderate business or financial risk are rated as 'B'. These should be addressed within the next 12 months. Findings that are procedural in nature, or reflect relatively minor administrative shortcomings, are rated as 'C'. Action on these findings is at the discretion of the entity.

25. Overall, the results of audit activity over the past year indicate that there has been a marginal improvement in the quality of control procedures over business and accounting processes. This is demonstrated by:

- the number of entities with 'A' category audit findings reduced to two in 2002–2003 from four in 2001–2002;
- the total number of 'B' category audit findings across all entities reduced from 116 in 2001–2002 to 96 in 2002–2003;
- eleven of the 21 entities reported an improvement in the number of 'A' and 'B' category audit findings; four entities showed a deterioration in their position, with six entities remaining in the same position; and
- the number of entities with no category 'A' or 'B' audit findings remained at two for both years.

26. The ANAO has identified 11 'A' category ratings overall. The Department of Defence has 10 'A' findings, a decrease of three from the previous year. The Australian Taxation Office has one 'A' finding, a decrease of two over 2001–2002. The Health Insurance Commission and the Department of the Environment and Heritage no longer have 'A' category audit findings.

27. A summary of 'A' and 'B' category audit findings by entity is outlined in Table 2 of Appendix 1.

Prospective issues to be addressed

28. The results of interim audits to date indicate that most entities have achieved a position where the fundamental processes relating to financial statement reporting are substantially in place. However, it is again clear this year that a small number of entities are yet to implement key elements of 'better practice' and still face considerable challenges in this regard, particularly the Department of Defence and the Australian Taxation Office.

29. The priority for entities now is to continue to implement 'better practice' financial management in their operations, so they are able to meet the challenges emerging with continued evolution of the Government's financial reform process, including:

- the progressive move over the next three years to much tighter year end financial reporting deadlines[8];
- the need to ensure budgeting and revised cash management requirements allow entities to meet their operating and reporting responsibilities; and
- continuing improved decision support through the implementation of more effective performance measurement processes and analysis in key operating areas, by better linking financial and non-financial information.

30. As was noted in last year's corresponding report, it is only through continued focus on these key areas that the initiatives can be achieved in a way that is cost effective. They need to be targeted at priority areas where there are significant cost and operating issues to be managed. Taking such steps would enable entities to achieve a more efficient deployment of resources. As well, it will also contribute positively to sound corporate governance through an increased understanding of financial risk and related management issues.

31. A related matter that was also noted last year, but continues to require further attention, is the management of IT security issues. Secure IT systems are

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[8] Budget Estimates and Framework Review—Department of Finance and Department of the Treasury Joint Review—Canberra 2002. Recommendation 2.

the fundamental building block for ensuring data integrity, which is a pre-requisite for reliable financial reporting. The use of measurement tools, particularly data metrics, is under-utilised as a means of monitoring movements in risk. Analysis of data metrics provides an important reference point for assistance in the validation of the integrity of IT systems. Areas where this analysis could be of value include:

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

32. The rationale for this approach is that risk management practices should demonstrate a coherent analysis of IT systems security issues balanced and prioritised against defensible risk acceptance positions as part of an overall risk management plan which acknowledges the trade-off with increasing costs.

Report timing

33. The purpose and timing of this report specifically recognises the increased responsibility being placed on entities to maintain an effective control structure as part of good corporate governance. The ANAO continues to be committed to the timely reporting of significant matters to assist the Parliament in its oversight of the financial aspects of public administration. The ANAO expects to report the results of the final audits to the Parliament in December 2003, as noted earlier.

Structure of the report

34. *Chapter 1* presents an overview of certain contemporary financial framework issues facing entities and the Commonwealth in relation to financial management policies, procedures and reporting. These issues are likely to have an impact in the future on the control structures and financial management practices of the APS.

35. *Chapter 2* briefly sets out the significance of internal control structures as a foundation for good corporate governance and sound financial management, and how these elements are taken into account from a financial statement audit perspective.

36. *Chapter 3* provides a summary of major issues relating to the internal control environments of Commonwealth entities examined.

37. *Chapter 4* provides a summary of the major issues relating to the audit of information systems focussing on the control issues associated with planning the IT environment, developing and delivering IT solutions, operating the IT environment, and organising and monitoring IT processes.

38. *Chapter 5* provides a summary of the controls over financial systems and processes from a financial statement audit perspective for each of the Commonwealth entities examined.

39. *Chapter 6* outlines the results of internal control structure, business and accounting processes and systems examinations, for each of the Commonwealth entities covered, as part of the audits of their financial statements.

40. *Chapter 7* outlines the results of a recent Business Support Process (BSP) audit in relation to the Financial Aspects of the Conversion to Digital Broadcasting by the Australian Broadcasting Corporation (ABC), which was requested by the Minister for Communications, Information Technology and the Arts.

Control Structure Issues

1. Influences and Issues Affecting Public Sector Financial Management

Introduction

1.1 Since 1999–2000, the APS has budgeted, operated and reported under the accruals-based outputs and outcomes framework. This framework is designed to enhance the performance and public accountability of APS entities by driving improvement in the way they plan, implement and measure their results. In addition to the changing overall financial management environment in which the Parliament authorises appropriation funds, the new framework has required individual entities to adopt more business-like financial management practices.[9]

1.2 In order to bring about the fundamental changes necessary for resource management within the new performance framework, entities have needed to develop financial systems, internal budgeting and reporting arrangements that provide managers with access to information which properly reflects the full costs of their operations[10]. This information is necessary to demonstrate a clear relationship between outputs and outcomes and is fundamental for effective decision-making.

1.3 All Government entities have evolved their financial management frameworks to varying degrees in recognition of a number of influencing factors. Foremost amongst these are:

- the increasing requirement to implement robust risk management frameworks to assess and manage operational and financial risks;
- the increased focus on governance issues;
- the significant investments made in IT and FMIS; and
- the introduction of reporting requirements which accord with the budget outputs and outcomes initiatives.

1.4 The APS financial management framework will continue to be reassessed as the ongoing evaluation of issues and the emergence of new influences requires the entities to respond in an increasingly sophisticated manner. This necessitates implementation of appropriate financial management policies and procedures

[9] ANAO Audit Report No.52 2001–2002. *Internal Budgeting*. Excerpts.

[10] ANAO Audit Report No.2 1999–2000 *Use of Financial Information in Management Reports*. Excerpts.

which will increase the effectiveness and efficiency of APS financial and operational activities.

1.5 The ANAO adopts a risk-based audit approach which includes analysis of the specific elements of the control, stewardship and leadership components of corporate governance. This approach, from a financial statement perspective, is well tested and remains relevant, as the risks are timeless.

1.6 Central to this approach is the independent identification and examination of business and financial risks together with the strategies, controls and actions in place to manage those risks. The ANAO looks to ensure that the internal control structure exhibits those elements that contribute positively to sound corporate governance.

1.7 For 2002–2003, audit issues relating to the internal control environment, similar to those in previous years, are in relative proportion to the size and scale of activity undertaken by the Commonwealth. They indicate a 'risk range' of exposures extending from moderate to significant.

1.8 At an entity level, the report card shown at Table 2 of Appendix 1 indicates broadly the status quo with audit findings. While the ANAO and entity managements work at resolving issues, governance standards dictate that the findings need to be eliminated.

Key issues

1.9 The majority of the Commonwealth's financial activities is concentrated in taxation and excise revenue, welfare and benefit payments, defence and property assets, and debt financing.

1.10 The ANAO has identified a number of currently emerging influences which it considers will have a significant impact on the future direction of APS financial management. Similarly, these influencing factors have raised a number of more immediate issues which entities will be required to consider and respond to accordingly.

1.11 A diagrammatic representation of a selection of these current influences and issues is shown at Table 1 at the end of this Chapter.

1.12 The following four of these influences are discussed below in greater detail:

- integrated risk assessment and management;
- quality and meaningful financial reporting;
- increasing focus on governance responsibilities; and
- increasing emphasis on performance assessment and measurement.

Integrated risk assessment and management

1.13 Risk assessment is widely accepted as a key business process, and the ongoing management of risk is accepted as best practice at an entity strategic level as well as a means of improving operational performance.

1.14 Managing risk embraces both the minimisation of the impact of exposures, as well as the positive acceptance of risk as a part of the process of using opportunities to create more productive use of resources.

1.15 The development and maturing of modern risk management in the Commonwealth public sector is a late 1990s response to the establishment of Australian Standard AS/N2S 4360 in 1995, which was updated in 1999.

1.16 The means for testing risk tolerance includes the establishment of appropriate control frameworks to manage risks effectively.

1.17 An important perspective on risk assessment and management is gained when the question is asked as to how risk is identified and measured at an organisational level and how that impacts on, and creates obligations at, the Commonwealth level.

1.18 A measure of the maturity of risk management in the Commonwealth is the extent to which organisations have embraced organisation-wide risk management, sometimes known as enterprise risk management, and integrated it into their strategic objectives and operational culture.

1.19 An ANAO audit of risk and insurance is scheduled to be tabled in July 2003. That report, which includes the results of a survey of 50 Commonwealth entities, provides insights into the level of implementation of risk management practices in the APS.

1.20 The means of treating risks extends beyond disciplined management practices operating within the respective entities and, for certain measurable risks, includes the hedging of potential financial impacts through insurance. Sound business processes influence both the availability of cover and the cost of the insurance. Premiums need to be priced efficiently, based on a realistic assessment of the exposure, but must also allow for a measure of how much capital is needed by the Commonwealth to offset the underlying long-term exposures.

1.21 The Commonwealth has centralised insurance services for general government sector agencies via ComCover and ComCare. These arrangements provide the mechanism for treating insurable risk in the Commonwealth. Both ComCover and ComCare finance their operations from premiums charged to individual entities based on their respective risk ratings.

1.22 In essence, the financial risk in insurance concentrates on consideration of events, commitments or contingent liabilities which indicate a potential impairment of, or diminution to, the value of an asset, or the incurrence of an unplanned liability. The scope exists within entities to influence their levels of insurance cover and hence the amount of premiums paid to ComCover and ComCare. Consequently, the premiums are under constant pressure in terms of pricing, claim costs, provisioning and reinsurance.

1.23 The use of insurance, as a formal risk treatment in the Commonwealth, is still developing. Organisations need to be able to demonstrate the link between risk management and the application of insurance as a risk mitigation strategy.

1.24 Continuation of the above trends is likely to result in the cost, and use, of insurance having the potential to create significant risk management issues in the Commonwealth.

Quality and meaningful financial reporting

1.25 There have been significant developments in, and further proposals to reform, the future direction of financial reporting in Australia.

1.26 In an environment where the importance of quality financial reporting is given emphasis, this commentary serves to highlight the importance of financial statements in the APS.

1.27 Transparent and relevant financial reporting is a much sought-after goal and has important implications for the APS for two reasons.

1.28 First, the reporting needs to demonstrate proper use of resources and, second, it should be relevant for decision-makers. Financial statements are complementary to these goals. They are designed to reflect stewardship standards adopted and to give real meaning and support for strategic and operational decision-making.

1.29 APS financial reports are not routinely used for decision-making to any great extent. Their focus is compliance oriented and there is an associated significant cost burden in their preparation. A further issue, unique to the public sector, concerns the application of accounting standards and their impact on decision-making. Lease financing arrangements and taxation revenue accounting are particular cases in point.

1.30 The lease financing issue is fundamentally about whether an entity uses its own financial resources, or external finance, to acquire an asset as opposed to incurring rent for the use of somebody else's assets. When the entity utilises its own, or external, finance for the asset acquisition, entity resources are committed over the particular asset life cycle. This can cover a considerable number of years and commits the entity to taking on the risks associated with asset ownership. This is in direct contrast to incurring a rental cost, as part of the entity's annual operating expenses, for the use of an asset. This judgement involves consideration not only about the buy/rent decision but also involves issues regarding competing asset resource allocation priorities. The primary rationale behind the transaction needs to be well considered. Application of the relevant accounting standard, whilst classifying the transaction, must be consistent with the intended rationale of the underlying arrangement. Experience to date, however, demonstrates the reverse outcome of this approach within the general government sector.

1.31 The taxation revenue accounting issue arises from revenue estimates which are prepared on the basis of the tax assessment liability recognition method. At a whole of government level, the Commonwealth recognises taxation revenue on a due and payable principle i.e., cash and assessment. This is contrary to the relevant accounting standard which also includes recognition of revenues being earned, yet to be received, and assessed.

1.32 The treatment has resulted in a difference of approximately $25.7 billion in accrued revenue, and $18.1 billion in liabilities, disclosed in the statement of financial position of the Australian Taxation Office's (ATO) financial statements compared to that shown in the Commonwealth Consolidated Financial Statements.[11]

1.33 In the above circumstances, there are two different revenue measurements in the Commonwealth. First, at the ATO level and second, at a Commonwealth level, both in terms of the Budget and the Consolidated Financial Statements.

1.34 Accrued taxation amounts are not included in the Budget and the Consolidated Financial Statements because of whole of government sensitivities to variations with revenue estimates.

1.35 Since the creation of a single Australian Accounting Standards Board (AASB), there has also been discussion at a Commonwealth strategic policy level, as to whether there should be a uniform set of accounting standards to address issues for particular reporting sectors.

1.36 The Commonwealth has now had some four years' experience with accrual budgeting and almost ten years experience with accrual financial reporting. It has become increasingly clear that accounting in a Commonwealth Government context raises specific issues that have no equivalent in the private and not for profit sectors.

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[11] ANAO Audit Report No.25 2002–2003 *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002*. ANAO, Canberra, December 2002, p. 28, paragraph 2.9.

1.37 The public sector will also need to resolve the differences[12] relating to the harmonisation of the Government Finance Statistics (GFS) framework and Australian Generally Accepted Accounting Principles (GAAP). The aim of this work is the development of an Australian Accounting Standard (AAS) for a single set of government financial reports to reduce current levels of confusion, and to aid transparency.

1.38 The recommendation from the Budget Estimates and Framework Review for the harmonisation of GFS was taken up by the Financial Reporting Council (FRC) in December 2002, when it announced the broad strategic direction for public sector accounting standard setting. The FRC announced:

> The Board should pursue as an urgent priority the harmonisation of Government GFS and GAAP reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.[13]

1.39 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. In this respect, the ANAO is represented on the Department of the Treasury's Heads of Treasuries Accounting and Reporting Advisory Committee's (HOTARAC's) Working Group for GFS/GAAP Convergence.

1.40 This Group has identified at least 14 differences between the two frameworks. Following analysis of these differences, the Group concluded that a number of the GFS concepts could be readily accommodated within an AAS for the public sector. However, some GFS treatments are not easily reconciled with the latter.[14] The Group will provide suitable material and suggestions to the AASB for any action they may wish to take in the standards arena. These issues also need to be considered in the broader context of Australia's commitment to adopt international accounting standards by 2005.

1.41 In addition to the above complexities, the introduction of International Accounting Standards (IAS) will also provide entities with a number of challenges both prior to, and subsequent to, implementation.

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12 ibid, p. 18, paragraph 1.10.

13 Bulletin of the Financial Reporting Council 2002-2005, 18 December 2002.

14 Department of Finance and Administration and Tasmanian Department of Treasury and Finance, March 2003, *Harmonisation of Government Finance Statistics and Generally Accepted Accounting Principles—Issues Paper*, pp. 5–6.

1.42 The decision by the FRC made on 28 June 2002, to support the adoption from 1 January 2005, of accounting standards issued by the International Accounting Standards Board (IASB) will have a significant impact on Government sector reporting.

1.43 Adoption of IASB standards will necessitate a complete review prior to that time of entities' information gathering, reporting and control systems. Furthermore, it will be necessary to have prior year comparatives when the IAS disclosures are first applied.

1.44 Such a review, and the consequent changes necessary for reporting compliance, where necessary, may represent a significant cost in time and resources for some entities.

1.45 The ANAO notes that AAS have not yet been developed in respect of the following four key topics currently covered by IAS:

- intangibles;
- recognition and measurement of financial instruments;
- accounting for post-employment benefits (superannuation and medical benefits); and
- obligations related to the disposal/retirement of long-lived assets.

1.46 The above topics have relevance for the APS and would require significant preparation to be undertaken prior to their introduction, particularly for some entities.

Increasing focus on governance responsibilities

1.47 There is growing impetus for an increased level of scrutiny over management performance following recent corporate failures overseas and in Australia. Much of the debate, however, centres on the private sector.

1.48 The response in Australia has been directed at improving corporate stewardship, disclosure and internal controls.

1.49 The Government's Commonwealth Corporate Law Economic Reform Program (CLERP) took another step towards reforming corporate governance standards in Australia with the release of Issue Paper No.9 *Corporate disclosure—strengthening the financial reporting framework*[15].

1.50 The CLERP paper No.9 reviews the focus on some of the most sensitive issues in Australia's corporate governance debate. The Government has provided

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[15] *Corporate disclosure—strengthening the financial reporting framework*. Commonwealth of Australia, CLERP Issue Paper No.9, September 2002.

the framework and underlying principles from which it intends to strengthen the corporate governance performance of Australian companies.

1.51 The proposed CLERP 9 reforms strengthen and clarify the roles and obligations of key corporate governance players—boards, audit committees, management, shareholders, external auditors and regulators.

1.52 The ANAO has provided guidance in a number of areas concerning audit committees, the finance function and internal budgeting. The ANAO is in the process of finalising a Better Practice Guide on Public Sector Governance dealing with the key elements, processes and principles of governance.

1.53 The APS is arguably ahead of the private sector in developing good governance practices. A number of CLERP 9 reforms and their underlying principles have been operating in public sector entities for several years. These include audit committees, monitoring of risk management, internal controls and internal audit, and fraud risk assessment.

1.54 However, the APS can improve further. Clear corporate governance performance standards, against which entities can measure the effectiveness of their governance structures and practices need to be developed.

Increasing emphasis on performance assessment and measurement

1.55 Over recent years, the Commonwealth has sought to improve the financial management and performance accountability of agencies, and has implemented a number of key reforms aimed at achieving this objective. A cornerstone of the reforms has been the introduction of accrual budgeting and reporting within the context of an outcomes and outputs framework.

1.56 Accrual budgeting and reporting has required all government entities to account not only for revenues and expenditures, but also to account for assets (and liabilities) and to recognise the costs associated with using those assets.

1.57 Underpinning the development of a comprehensive budgeting and reporting framework is the necessity to ensure that management is able to make effective decisions regarding the allocation of its resources on consistent and well informed bases.

1.58 In February 2003, the ANAO issued a Better Practice Guide on 'Internal Budgeting'. Budgeting and reporting are integral elements in the management of every organisation where decisions are continually required regarding the allocation, use and administration of scarce resources.

1.59 The ANAO guide noted that well developed and implemented budgeting processes are critical to providing a sound basis for controlling activity levels and for monitoring and managing financial performance. In turn, effective budgeting processes can be a key driver in the successful delivery of an organisation's outputs, for example services delivered.

1.60 A better practice framework for internal budgeting has three broad components:

- integrating internal budgeting processes with strategic planning, including the setting of priorities, and supporting them with a robust control and financial management structure;
- putting efficient and effective internal budget development processes in place, including the use of appropriate technology to provide decision-support tools; and
- regularly analysing performance against budgets, using consistent and timely flows of information and implementing auditable accountability measures.

1.61 When the framework is fully adopted, it will encourage more efficient and effective management of resources and improve the capacity of internal budgeting to support the achievement of organisational goals and objectives.

Conclusion

1.62 The Commonwealth's financial framework is based on an accrual-based outcome and outputs model. It is designed to allow the Parliament to see the real cost of delivering benefits to the Australian community (outcomes) and agency goods and services (outputs) [16].

1.63 The ANAO has observed that the key components of effective financial management include:

- access to relevant information;
- use of that information to enhance management standards; and
- assurance that the information is accurate, relevant and secure[17].

1.64 This and previous reports on control structures note that a fundamental pre-condition for the effective use of financial information is reliable and timely data. The APS financial environment continues to necessitate a high level focus on the control structures that facilitate Chief Executive Officers meeting their responsibilities under the *Financial Management and Accountability Act 1997* (the FMA Act). The ANAO audit places emphasis on significant business risks

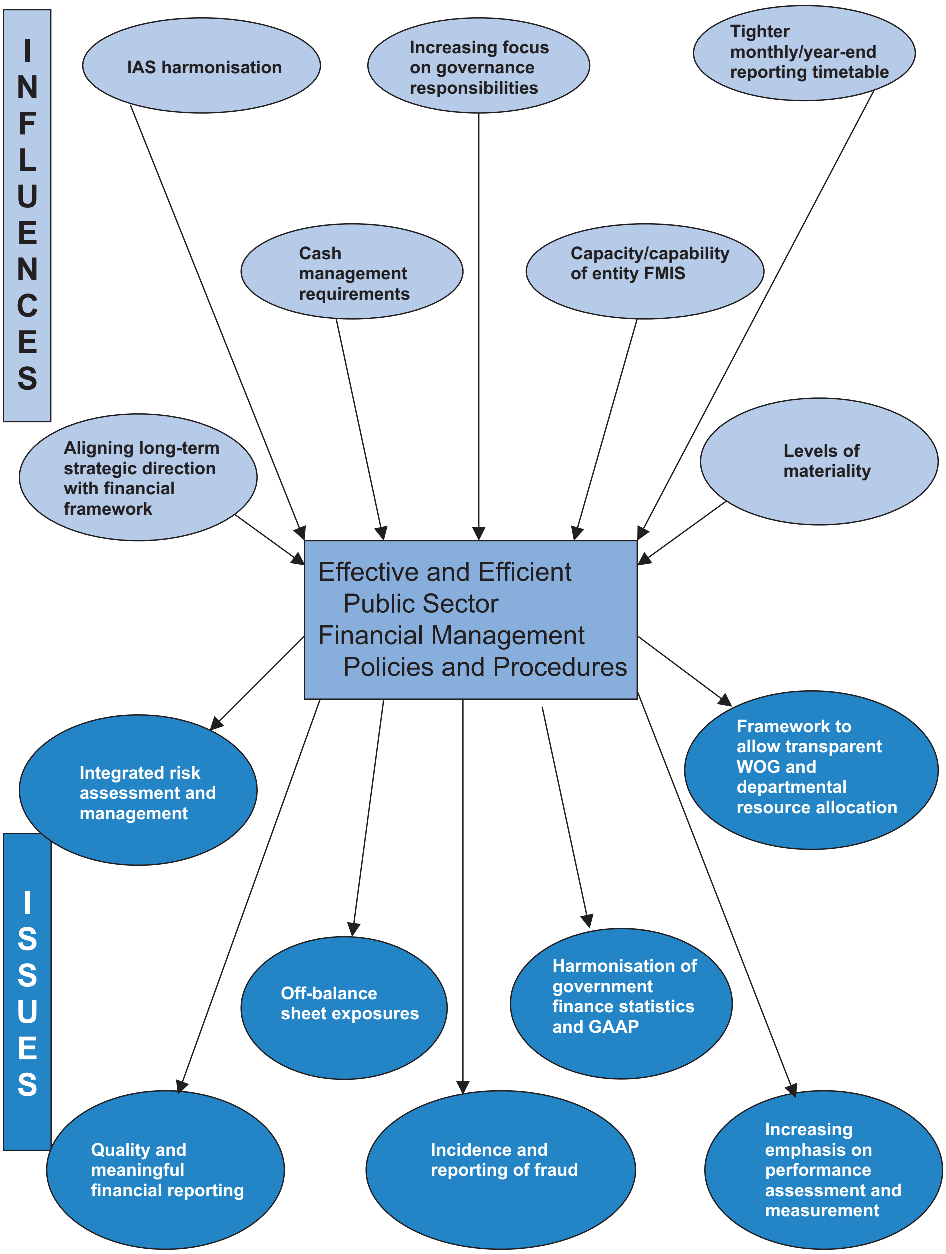
[16] Excerpts from Joint Committee of Public Accounts and Audit Report 388, June 2002, Foreword.

[17] Excerpts from Joint Committee of Public Accounts and Audit Report 376, May 2000, Foreword.

impacting on the APS financial operations, and on the evaluation of the design and effectiveness of those procedures identified to mitigate those risks. These areas and recognition of emerging issues, including the examples noted above, will pose significant challenges for APS senior management.

Table 1

Selected influences impacting on public sector financial management issues



Source: ANAO Internal assessment, June 2003.

2. Audit of Control Structures

Introduction

2.1 This report summarises issues relating to the control environment and control structures implemented by major Commonwealth entities, arising from the examination of financial and related systems, controls and processes as part of the financial statement interim audits of entities for the year ending 30 June 2003.

Defining and establishing an effective control structure

2.2 The FMA Act requires the CEO to manage the affairs of an entity in a way that promotes effective, efficient and ethical use of Commonwealth resources for which the CEO is responsible. This requirement cannot be achieved without effective corporate governance arrangements in place. From a financial statement perspective, an important element of corporate governance is an entity's internal control structure, which is defined in Australian Auditing Standard (AUS) 402, *Risk Assessments and Internal Control*, as:

> management's philosophy and operating style, and all the policies and procedures adopted by management to assist in achieving the entity's objectives[18].

2.3 The internal control structure reflects an entity's leadership style, commitment to risk management, the quality of its business processes, and its capacity to achieve its outputs and outcomes. An effective internal control structure is crucial to safeguarding an entity's assets and resources, preventing or detecting and correcting irregularities should they occur, and maintaining complete and accurate financial records, which allow the timely preparation of financial information for decision-making and statutory reporting purposes.

2.4 AUS 402[19] also states that the internal control structure extends beyond those matters that relate directly to financial reporting and consists of three elements: the control environment, information systems and control procedures. These three key components of the internal control structure are the primary focus of this report.

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[18] Australian Auditing Standard AUS 402, *Risk Assessments and Internal Controls*, issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, October 1995, paragraph 10.

[19] ibid., p. 4.

2.5 From an accounting and operational perspective, an effective control structure, tailored to each organisation's specific needs, will enable the entity to maintain appropriate management control over its assets, liabilities, revenues and expenditures.

Understanding an entity's internal control structure

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

2.7 ANAO testing is directed towards ensuring the existence of an effective control structure that, in the current environment, is critical to the accountability processes of all entities. The benefits ensuing from an effective control structure include:

- improved accountability through controls assurance;
- improved program and service delivery through efficient, effective and ethical use of resources;
- identification and minimisation of significant risks to achieving objectives; and
- achievement of an appropriate balance between the external demands for quality outcomes while maintaining effective internal governance.[20]

The ANAO's 2002–2003 audit cycle

2.8 Under section 57 of the FMA Act for agencies, and under clause 3, part 2 of Schedule 1 of the *Commonwealth Authorities and Companies Act 1997* (CAC Act) for Commonwealth Authorities, the Auditor-General is required to report each year to the relevant Minister on whether the entity's financial statements

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

have been prepared in accordance with the Finance Minister's Orders (FMOs) and whether they give a true and fair view of the matters required by those Orders.

2.9 Since October 2002, the ANAO has completed its audit planning; updated its understanding of the business and corporate governance arrangements; assessed audit risk; and designed and completed interim testing up to 31 March 2003. The results of this analysis and interim testing are outlined in the following chapters. All ANAO findings have been reported in detail; discussed with entities' management; and reported in summary to the relevant Minister(s).

2.10 The final phase of most audits will be completed in the April to September 2003 period and will be reported to Parliament in December 2003.

3. Internal Control Environment

Introduction

3.1 The internal control environment directly influences the way business and operations are undertaken in every entity. This requires it to be carefully reviewed when assessing audit risk. AUS 402[21] indicates that the control environment consists of, in summary, the following factors:

- management's philosophy and operating style—management's attitude and decision making processes relating to planning, supervision and review including risk taking, financial reporting and control;
- organisational structure—the framework within which activities for achieving its objectives are planned, executed, controlled and monitored;
- assignment of authority and responsibilities—the delegation of authority and responsibility in a way that makes the accountability process clear and which is based on sound business principles and risk assessment;
- internal audit—review and monitoring of the internal control structure independent of management;
- use of IT—the effective design, operation and control of IT in a way that is appropriate to the size and complexity of the entity's operations;
- human resources—the competency and honesty of personnel including their qualifications, training and their awareness of the need for internal control; and
- the audit committee—a forum for communication between management, internal and external auditors to assist the governing body enhance the control framework, improve the objectivity of financial information and comply with legislation and other obligations.

Elements which contribute to financial statement assurance

3.2 In conducting audits of an entity's financial statements, the ANAO focuses on specific elements of the internal control environment. In doing this, the ANAO establishes whether the environment comprises elements that contribute positively to the internal control structure and minimises both financial and non-financial risks to the entity. These elements include:

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[21] Australian Auditing Standard AUS 402, op. cit., paragraph 19.

(a) ***senior executive group arrangements***, and whether they meet regularly, focussing attention on the outputs and outcomes that need to be achieved including the strategic directions, business planning, control framework, financial results and operational issues;

(b) ***an audit committee***, and whether it meets at least quarterly, addressing issues such as internal audit planning and results, risk assessment and the control environment relating to business and accounting processes and financial systems;

(c) ***an internal audit function***, and whether it is independent of management through reporting directly to the CEO and/or the chair of the audit committee and works to an approved internal audit plan addressing management concerns, compliance with policies and procedures, business and financial risks;

(d) ***a risk management plan*** and ***fraud control plan*** which are current and whether they identify inherent risks, controls which mitigate those risks and any further actions which may be required;

(e) ***systems of authorisation, recording and procedures*** to ensure that transactions are processed, recorded and accounted for correctly;

(f) ***sound organisational business practices*** to ensure that operations are efficient, effective and measurable;

(g) ***financial and accounting skills commensurate with responsibilities*** and the complexity of business operations; and

(h) ***a financial reporting regime*** which prepares monthly analyses, including comparison of actual results to budgets, variance analysis and commentary.

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

Results summary

3.4 The cross entity results of audit testing of internal control environments, in summary for the major entities examined in this report, and set out in detail in Chapter 6, are as follows.

Senior executive group arrangements

3.5 It is important to consider the legislative responsibilities of CEOs operating under the FMA Act and Boards under the CAC Act and the distinctions between the two, when assessing the appropriateness of measures taken to govern entities operating under these Acts.

3.6 In general, Departmental Secretaries, as CEOs of FMA agencies, are governed by Part 7 of the FMA Act which essentially gives them responsibility for the overall management of the Agency. The CEOs of CAC Act bodies on the other hand, must work to, and in conjunction with, a Board of Directors or similar oversight body.

3.7 A critical aspect of the internal control environment is the leadership and performance of CEOs within these different management structures. The CEOs, along with their senior executive groups or Boards of Directors etc, are responsible for a number of governance responsibilities including:

- establishing, communicating and monitoring progress against corporate strategies and goals;
- approving budgets and allocating the entity's financial and human resources to effectively and efficiently achieve its strategies and goals;
- directing significant business processes and systems and determining/implementing appropriate policies and procedures;
- regularly monitoring progress against financial budgets;
- undertaking all key management decisions;
- ensuring accountability and transparency; and
- preserving Public Sector values and monitoring control frameworks.

3.8 At the financial management and reporting level, the senior executive groups/Boards of Directors must ensure financial and audit issues are properly planned, executed, controlled and monitored.

Findings

3.9 The CEOs of all entities covered by this report have established management boards or senior executive leadership committees to plan and monitor strategic direction and performance. In addition, these senior executive committees are often supported by sub-committees such as the finance committee, IT committee, or security committee to focus on specific issues and projects. It was noted that financial management and operating performance were, in all cases, key agenda items, and that these committees and the CEOs were regularly briefed on significant audit and/or accounting issues.

3.10 All entities have produced a formal Corporate Plan or strategy document which articulates how each entity perceives its environment and primary role, and which also outlines the broad strategic course of the organisation being charted by the CEOs and senior executive groups.

3.11 The ANAO noted that CEOs and senior executive groups continue to give appropriate priority to financial, accounting and audit matters.

3.12 However, it was also noted that only a few entities monitor their operating performance against key non-financial measures. The ANAO considers a significant issue for all entities is the continued development of key performance measures and reporting of them across the non-financial, as well as financial, areas of their operations.

3.13 The ANAO acknowledges the diversity of operational imperatives and responsibilities across public sector entities, but considers that the identification and regular reporting of a select few, appropriately targeted measures in 'key areas' would increase management's ability to achieve their respective corporate strategies.

3.14 These key areas include:

- financial—operating expenditure, capital spending;
- customers/stakeholders—activities to improve service satisfaction;
- environment/community—activities contributing to the community;
- internal operations—measures of quality, responsiveness;
- employee satisfaction—measures of increased satisfaction; and
- employee learning—measures for staff development.

Audit committees

3.15 The ANAO notes that there continues to be a general focus on the important role that audit committees undertake in oversighting corporate governance and the relationship between corporate governance and the performance of an entity. In particular, this focus continues to be on:

- internal controls, ethics and codes of conduct;
- regularly monitoring of the internal control environment through reviewing the work of the internal audit function;
- recognising the importance of the internal control environment to the effectiveness of internal controls;
- business and financial risk assessment processes;
- the independence and financial expertise of audit committee members

and their capacity to question management on key strategic, operational, audit and accounting issues; and

- the need to maintain strong lines of communication with both the internal and external auditor and to keep the CEO informed of issues arising through the oversight of the audit committee.

3.16 In relation to the business and financial systems and their impact on the preparation of financial statements, an effective audit committee should validate and follow through on:

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

Findings

3.17 Overall, entities generally have audit committees that assist the CEO, any governing bodies, and the executive to foster and maintain an appropriate control culture. All audit committees would benefit by closely examining their role and charter going forward, as a means of becoming a valuable facility to assist CEOs and governing bodies meet their governance responsibilities. This continues to be particularly so in respect of risk assessment, security and best practice financial management and reporting.

3.18 ANAO senior audit staff attend audit committee meetings as observers. The ANAO has noted in the past year that:

- all entity audit committees have formally approved the Internal Audit programs;
- a number of entity audit committees have reassessed their composition resulting in a greater number of committees which have independent members as noted below;
- a number of entity audit committees have reviewed and updated their Audit Charter; and

- a number of entity audit committees more actively oversee both the quantitative and qualitative issues surrounding preparation of financial and operating information for external publication (e.g. annual financial statements, and Portfolio Budget Statement submissions).

3.19 Of the 21 entities reviewed this year, only three do not have truly independent non-executive members with specialised skills and knowledge who can bring a broader perspective to corporate governance issues. The appointment of independent non-executive members to audit committees is considered by the ANAO to constitute better practice[22]. Even better practice is to have an independent chair. Of the 21 entities examined, only four currently have an independent chair.

3.20 A deficiency noted last year related to the lack of follow-up by a few audit committees of the implementation of internal audit and ANAO recommendations. This deficiency has now been addressed to the point that all audit committees now regularly and formally monitor the implementation status of internal/external audit recommendations.

3.21 As a result of the increased focus on the scope and quality expectations of the work carried out by the Internal Audit function, a trend in recent years has been the outsourcing of this function to the external accounting firms because of the difficulties in recruiting the necessary skills 'in-house'.

3.22 A majority of the 21 entities examined for this report have outsourced the internal audit function.

3.23 A consequential impact of this arrangement is an increased necessity to ensure that the external providers deliver an effective and efficient service within the overall context of providing 'value for money'.

3.24 The ANAO considers that this monitoring function is the responsibility of the entity's audit committee.

3.25 It was noted that, at present, only nine of the 21 entities in this report have formal procedures in place to assess whether the internal audit function delivers an effective, efficient, and value for money service.

Internal audit function

3.26 As with audit committees, an independent and effective internal audit function continues to be an integral component of the system of internal control and a source of assurance to the CEO, governing body/executive and audit committee on control, business and financial risk, and other corporate

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22 ANAO Better Practice Guide, *Audit Committees*, ANAO, Canberra, July 1997.

governance issues. To achieve this outcome, it is critical that the internal audit function:

- assesses the organisational risk profile of the entity, and ensures risk mitigation processes are in place to keep risk within organisational profiles agreed by the executive;
- develops a comprehensive strategy for internal audit coverage which considers the key organisational and financial risks and which is presented to the audit committee for approval;
- makes fundamental contributions to corporate governance by providing vital, incisive and relevant information on control, conformance and performance issues;
- is led by an experienced senior executive who has a professional understanding of the audit role and unrestricted access to senior management and the audit committee;
- has the skills, knowledge and resources to be able to provide timely advice and support to the audit committee and the capacity to exercise sound judgement when dealing with, and when providing advice to, management; and
- has corporate systems to ensure compliance with auditing standards and which incorporate adequate and effective information systems and reporting processes to enable the achievement of high performance.

3.27 Traditionally, the work of internal audit has had a strong compliance focus on areas such as:

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

3.28 Increasingly, internal audit is also being used as a management tool to undertake more value added assignments such as risk assessments, performance reviews, system pre-implementation reviews and financial reporting analysis.

Findings

3.29 The continuing emphasis on corporate governance has meant that key performance issues for internal audit continue to centre on:

- the performance and organisational risk issues, as well as the traditional aspects of compliance and control appraisal; and
- the capability to maintain an in-house cost-effective service delivery.

3.30 These issues continue to be particularly relevant when entities, or parts thereof, are experiencing substantial change, such as the implementation of new large systems or programs where the capacity to deliver a balanced blend of organisational risk, performance and compliance audit reviews is essential.

3.31 The ANAO noted that there is presently a large divergence between entities in relation to the relative proportions of time spent on the internal audit work program for financial compliance and control assessment compared to other broader based performance issues.

3.32 The proportion of resources spent on financial compliance and control work by the entities examined in this report varied between approximately 10 per cent and 80 per cent respectively of their total internal audit work program. The balance, 90 per cent to 20 per cent respectively, is spent on reviewing issues that are of significance from a performance, operational or efficiency perspective.

3.33 The ANAO also noted that the increased level of monitoring of internal audit work programs by audit committees has ensured that all the programs in the entities reviewed are on schedule to be completed within the timeframes proposed and signed off by the respective audit committees for the 2002–2003 year.

3.34 In respect of compliance and control issues, the ANAO continues to note that, for the most part, entities have reasonably effective and independent internal audit functions which contribute positively to providing assurance on the key systems, processes and financial statements of entities. Nevertheless, the heightened focus on broader corporate governance issues means that most entities will need to reassess continually their internal audit capabilities.

Risk management plans

3.35 Assessing and managing risk has been an integral part of the APS reform program of recent years. A sound risk management framework will assist entity managers to be more objective in their approach to achieving required results as well as being able to defend publicly their decision-making, as part of their overall accountability for entity performance.

3.36 The key messages that the APS reform program on risk management has attempted to instil over recent years include:

- formal and systematic risk assessments are to be undertaken and directly linked to business plans, strategies and supporting operational initiatives;
- risk management planning also presents performance improvement opportunities, in addition to the assurance benefits that arise; and
- risk identification is an 'entity-wide' process that requires a structured assessment and evaluation process to ensure appropriate prioritisation of resources to be used in responding to the highest rated risks.

3.37 In the absence of a formal risk assessment and management processes, it is difficult to be assured that resources are deployed in an efficient, effective and ethical manner. As part of corporate governance, a sound risk management plan which is subject to regular updates will contribute to financial statement assurance through:

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

3.38 The ANAO considers it is a fundamental requirement that entities develop and continually refine control and performance measurement techniques, such as data metrics, which can be used to monitor progressively trends and changes in risk. The use of data metrics in this way requires entities to evaluate continuously risk in key functions or business operations against the background of control frameworks and performance monitoring and review. The ANAO considers there is real potential to develop metrics that demonstrate increased productivity and improved staff capability as a result of significant expenditure on IT, professional development, training and consulting services.

3.39 Data metrics can also be used to monitor risks in the area of IT security, and include:

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

Findings

3.40 Risk management continues to be an area of primary focus for audit committees.

3.41 All entities were observed to either have final, or close to final, formal risk management plans and strategies. Similarly, education, training and awareness in risk management all continue to evolve. As well advances have been made in ensuring risk awareness, and management thereof, is a part of the operating processes of the entities.

3.42 A number of entities are yet to develop formally performance measurement techniques and indicators which can be used to assess and monitor risk on an ongoing basis, although a number of entities have commenced consideration of this issue. As part of that process, entities need to give increased consideration to the use and linking of control, risk and performance metrics to assist with regular financial and performance monitoring.

3.43 Overall, the ANAO considers a majority of entities have continued to devote resources to the further enhancement of this area of their corporate governance framework and are fostering a risk management 'culture' within their organisations.

Fraud control plans

3.44 The Commonwealth's approach to fraud control was first enunciated through its *1994 Interim Ministerial Direction on Fraud Control*[23]. Updated *Fraud Control Guidelines*[24] released in May 2002 outline principles for fraud control within the Commonwealth and set national minimum standards to assist agencies in carrying out their responsibilities to combat fraud against their programs. The importance of entities establishing effective fraud control arrangements is recognised in s. 45 of the FMA Act, where CEOs are responsible for the implementation of a fraud control plan and for reporting to portfolio ministers on fraud control within their agencies.

3.45 Further explanation of the responsibility for preventing and detecting fraud is provided in AUS 210, *The Auditor's Responsibility to consider Fraud and Error in an Audit of a Financial Report*[25]. This standard states:

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[23] *Interim Ministerial Direction on Fraud Control*, Better Practice for Fraud Control, Canberra, 1994.

[24] *Fraud Control Guidelines* Issued by the Minister for Justice and Customs, under Regulation 19 of the Financial Management and Accountability Regulations 1997, May 2002.

[25] Australian Auditing Standard AUS 210, *The Auditor's Responsibility to Consider Fraud and Error in an Audit of A Financial Report*, issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, January 2002, paragraph 10.

> The primary responsibility for the prevention and detection of fraud and error rests both with those charged with the governance and the management of an entity.

3.46 The ANAO has in the past carried out a survey[26] which reviewed entities' fraud control frameworks in light of the requirements and guidelines noted above.

3.47 As with risk management plans, fraud control plans need to be regularly reviewed and updated when significant changes to roles or functions occur, to reflect the current fraud risk and control environment for the entity.

Findings

3.48 Fraud control planning is now well-established following issuance of the Commonwealth's *Interim Ministerial Direction on Fraud Control*[27] and the *Fraud Control Guidelines*[28]. Actions undertaken by most entities include:

- annual reviews of fraud risk assessments and fraud control plans by audit committees;
- articulating fraud planning in Chief Executive Instructions (CEIs);
- inclusion of fraud awareness topics in induction courses and the development and running of fraud training courses; and
- listing of fraud control plans on entity intranet sites.

3.49 Some entities have also established links with law enforcement agencies such as the Australian Federal Police (AFP) and distribute the AFP Comfraud Bulletins to staff to increase the awareness of current fraud issues.

3.50 Larger entities have also established fraud control sub-committees to manage fraud control performance by groups/states measured against fraud control action plans. Fraud control plans in some larger entities are also integrated with other related documents, for example, integrity plans incorporating codes of ethics and conduct.

3.51 Continuing education and sharing of information are required to ensure:

- greater awareness by staff of the potential for fraud, particularly around access to cash, credit cards, bank accounts and other attractive items such as computer equipment. Increasingly, tendering, purchasing and contract management are also areas which are subject to fraud;

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[26] ANAO *Survey of Fraud Control Arrangements in APS Agencies*, Audit Report No.47 1999–2000, June 2000.

[27] Interim Ministerial Directions on Fraud Control, 1994, op.cit.

[28] Fraud Control Guidelines, May 2002, op.cit.

- recognition that, when entities are experiencing significant change such as system or program implementations, the risk of fraud often increases; and
- clearer articulation of how to deal with allegations of fraud, including the referral processes to entities such as the AFP.

3.52 All entities need to continue to focus attention on these areas. *The Commonwealth Fraud Control Guidelines 2002*[29] outline entity responsibilities for fraud prevention, reporting of fraud information, fraud investigation case handling, training of entity fraud investigators and fraud prevention officers. All entities need to continue to update and refine on a regular basis, their fraud control processes accordingly.

3.53 At the time of preparation of this Report, the ANAO is also finalising its latest survey of fraud control arrangements in APS agencies covering 160 agencies including 74 FMA agencies and 86 CAC bodies. The survey sought to establish among other things:

- whether agencies had adopted the Commonwealth definition of fraud;
- whether there were any changes to the nature of fraud being committed; and
- the changes in the level of fraud against the Commonwealth.

3.54 The survey report is expected to be tabled in August 2003.

Systems of authorisation, recording and procedures

3.55 Against the background of the introduction by the Commonwealth of the accrual accounting framework on 1 July 1999, entities were required to reassess and to update their systems of authorisation, policies and procedures. Principal amongst these were entities' Chief Executive Instructions (CEIs) which reflect the powers delegated to management by Chief Executives under the FMA Act.

3.56 Formal and well documented systems of authorisation, recording and procedures are necessary to ensure that transactions are processed, recorded and accounted for in accordance with the directives of the responsible governing body and/or CEOs and other positions with delegated or statutory authority.

Findings

3.57 The results of ANAO audit work indicate that systems of authorisation, recording and procedures are now well understood and formally established in most entities.

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[29] ibid.

3.58 A number of entities have also reviewed and updated their CEI documents since their initial publication. Areas that require continual assessment and refinement include:

- completing and approving control checks over operational and key accounting processes; and
- reconciling and validating data transferred between operational systems and financial management information systems.

3.59 Authorisation of reconciliation processes and compliance with approved procedures remains a critical focus of the management and audit process. Continuous vigilance in these areas is critical for all entities.

Sound organisational business practices

3.60 Entities continue to face the challenges of reviewing their respective resource allocation judgments and processes to demonstrate that their outcomes/ outputs are properly met.

3.61 In order to achieve this objective, entities continue to adopt more 'business-oriented' practices. This has resulted in a continued move towards refining the approach to the assessment of efficiency and effectiveness of individual areas within entities through the budgeting and reporting process. This approach includes:

- providing management with incisive data metrics which demonstrate the efficiency and effectiveness of resource allocation decisions;
- having a stronger focus on the improvement of service delivery, and asset and liability management issues;
- comprehensive review of entity performance through strategic, operating and financial reporting processes;
- increased consideration of the impact of the financial information on the strategic and business planning processes;
- greater focus on the internal budgeting process to ensure the full costs of each aspect of an entity's operations are fully identified and able to be allocated and reported on; and
- assessing the contestability of service delivery, and considering development of partnership or alliance arrangements with suppliers.

3.62 Giving effect to the changes required of this approach also meant that most entities needed to enhance the project management skills of their staff, particularly in relation to contestability and outsourcing issues.

Findings

3.63 There continues to be inconsistency in relation to improved business practices across the entities reviewed in this report. Most entities have now adopted a range of practical and effective improvements to enhance performance including:

- implementing appropriate budget software and financial reporting tools;
- undertaking business process analysis and implementing detailed cost attribution programs;
- improving cash and debtor management, often through the creation of a treasury management function; and
- refining asset management plans.

3.64 These achievements have also resulted in improvements in project management skills and greater program and corporate coordination across entities.

3.65 Despite the achievements of some entities, most need to continue to focus attention on adopting one or more business practice improvements relevant to their operations. The ANAO noted during the current year that:

- there continues to be a lack of adequate consideration of the impact of financial data, such that it is not always comprehensively integrated into the strategic and operational business planning process for a number of entities;
- very few entities have developed a formal, integrated analysis framework to enable them to make fully informed management decisions to allocate financial and/or human resources or on a priority basis; and
- there is a lack of appropriate non-financial reporting on a regular basis across a large number of entities.

Financial and accounting skills commensurate with responsibilities

3.66 Adequate financial and accounting skills, commensurate with the size and complexity of an entity’s operations, are an essential component of a successful and robust internal control environment. In addition to the capacity to process and account for financial information, implement and manage financial systems and produce accrual and cash based financial reports, an entity should also possess adequate financial and accounting skills to enable it to:

- develop financial plans and business models which reflect the strategic directions of an entity;
- exercise sound financial judgement on business and operational issues; and
- inject costing, financial and activity analysis relating to financial and operational performance into the management of the entity.

3.67 An appreciation of these issues is also becoming increasingly important for all staff given the continuing focus on understanding and containing costs, obtaining value for money on contracts for services, and ensuring program expenditures are utilised in the most efficient and effective way.

Findings

3.68 Entities are continuing to develop their financial and operational, analysis and forecasting capabilities. The continuing tight employment market for people with appropriate skills has meant that most entities are still experiencing turnover of key financial staff which has made the development of financial skills around their individual business plans and strategic directions more difficult. In addition, a number of entities continue, in varying degrees, to be dependent upon the use of short and medium term contractors and/or consultants, particularly in relation to the preparation of their annual financial statements. Entities must continue to ensure that they:

- enhance their financial knowledge and analysis/modelling skills consistent with changes in their operational issues and strategic directions; and
- manage their financial and accounting skills knowledge base to ensure there is not undue on-going reliance on contractors and consultants without appropriate longer term management and/or service agreements in place.

3.69 While most entities are progressing these issues, it is expected that further progress for most entities will continue to be uncertain, as staff turnover in financial and operating positions and reliance on contractors and consultants, continues.

3.70 The ANAO considers that further development for most entities is necessary to ensure that there is a coherent and transparent rationale between strategic issues, and the consequential resource allocation decisions. The outcomes will need to be closely linked to the long-term direction and objectives of the respective entities.

Financial reporting

3.71 Better practice financial management involves producing regular i.e. at least monthly, internal management reports for decision-making which are meaningful, timely and relevant. Better examples of internal financial reporting include a summary snapshot outlining overall performance and following this with a set of accrual based financial reports encompassing statements of financial performance and position and cash flow statement presenting comparative analysis, explanations of variances and accompanied by relevant notes or commentary including, where appropriate, graphical presentation.[30]

3.72 This form of management reporting is considered fundamental to enable CEOs and senior management to meet their responsibilities under the FMA and CAC Acts to ensure resources are expended effectively, efficiently and ethically.

3.73 The preparation of comprehensive financial reports together with meaningful analysis on a monthly basis is also considered important in regard to monitoring the accuracy of an entity's annual financial statements.

Findings

3.74 Over the past year all entities have continued to expand and refine their levels of financial reporting.

3.75 The ANAO notes that, notwithstanding the improvements made during the last few years, a few entities have difficulty in preparing their monthly financial reports on a full accrual basis.

3.76 This issue is particularly pertinent in light of the much shorter timeframes which will be introduced in respect of year-end reporting by 2005 as part of the Department of Finance and Administration's recent *'Budget Estimates and Framework Review'*[31].

3.77 In all cases, the ANAO considers that further financial reporting improvement is necessary, particularly with respect to improved financial analysis and commentary to assist CEOs, executives and staff with financial responsibilities to adequately monitor financial and operating performance. Improvements in this area will deliver more detailed understanding of the entity's performance and, from a financial perspective, allow relevant managers/ executives to gain improved knowledge as to:

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30 Management Advisory Board, *Beyond Bean Counting, Effective Financial Management in the APS—1998 & Beyond*, Canberra, 1997, p. 57.

31 *Budget Estimates and Framework Review*—Department of Finance and Department of the Treasury Joint Review -Canberra 2002. Recommendation 2.

- how resources are being utilised across major activities;
- how administered revenues and/or expenditures are trending;
- the cost impact of large expense items such as IT and their relationships to key business operations; and
- the carrying values of assets and amounts of liabilities, and whether asset replacement strategies and liability reduction programs are appropriate.

Conclusion

3.78 In last year's corresponding report, it was noted that improvement had been made across a number of the key areas contributing to a sound control environment, but that progress was still required in the following areas:

- risk awareness, assessment and management, including the use of performance measurement tools such as data metrics to monitor trends in risk; and
- the quality and presentation of monthly operational and financial reporting.

3.79 This year's audit observations indicate that further progress has been achieved in ensuring the internal control environment continues to be strengthened across all entities reviewed in this report. However, ongoing refinement is necessary, particularly in respect of:

- increased executive committee analysis of organisational effectiveness and efficiency, particularly in the review of validating service delivery standards;
- the expansion of the monthly reporting process to encompass increasingly non-financial measures of performance, leading ultimately to a meaningful and comprehensive analysis of each entity's operations and performance;
- increased formalisation of audit committee analysis of the effectiveness and efficiency of entity internal audit review processes; and
- a more concerted response to the increasing focus on corporate governance issues:

(i) first, at a **conformance** level, by:

  - ensuring that the audit committee comprises at least one independent member who has relevant subject matter expertise and financial acumen; and

- having the audit committee chaired by a professional executive independent of the entity's management structure; and

(ii) second, at a **performance** level, by:

- ensuring entity financial capability is aligned with, and complements, both its strategic goals and long-term organisational requirements;
- continuing risk evaluation across strategic and operational processes to integrate more fully a risk management culture within the entity. A particular emphasis arising from this year's review is the need for instigation of arrangements for the ongoing identification and analysis of risks within the operation i.e. not just as part of an annual review; and
- continuing emphasis on enhancing the components of sound business practices.

3.80 These are areas that most Commonwealth entities would benefit from in terms of reviewing their existing internal control framework and corporate governance arrangements. The ANAO will look to examine the issues in these areas and monitor developments over the coming year.

4. Information Systems

Introduction

4.1 The Commonwealth Government has a significant and growing investment in information and communications technology (ICT). During 1999–2000 the Commonwealth Government spent an estimated $2.04 billion, or 7 per cent of total government operating expenditure, on ICT[32]. It is likely that this quantum of expenditure also continued in subsequent years.

4.2 Against the background of the opportunities to improve service delivery and to increase service efficiency, made available through ICT, the Government has established a solid Internet transactional presence that is second only to the United States in leading the transition to e-government.[33] E-government involves the transformation of government service delivery through the appropriate use of new technologies, and has the potential to provide better customer focus and access, greater availability of information, and improved business processes and efficiencies. Increasingly, Commonwealth entities are using e-commerce to conduct business online with their suppliers, thereby reducing the inefficiencies of traditional paper-based trading. Already 46 per cent of Australian citizens and 57 per cent of businesses have access to government information and services effectively available 24 hours a day, 365 days a year. Demand for such services is expected to grow by more than 30 per cent per annum[34].

4.3 New technologies provide the tools or 'enablers'. However, it is the transformation of the business processes within entities that will deliver the service benefits and efficiency outcomes. In addition, new technologies have also introduced increased complexity, speed, interconnectivity and dependence on information systems within the IT environment, which can involve substantial costs and increased risks, but also improved productivity.

IT governance

4.4 Given the Government's significant investment in IT and the growing dependence on its information systems, with the associated opportunities, benefits and risks, entities need to establish appropriate IT governance practices to assure their deployment of IT meets corporate goals through increased productivity, within a cost effective, prudent control environment.

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32 Year Book Australia 2003, Communications and Information Technology, Government Use of Information Technology, Australian Bureau of Statistics, Canberra.

33 United Nations Division for Public Economics and Public Administration report, *Benchmarking E-government: A Global Perspective*, June 2002.

34 DMR Consulting report, the E-government Benefits Study, March 2003

4.5 IT governance provides the leadership, organisational structure and processes which ensures that objectives are set, the methods to attain these objectives are clear, and the manner in which performance will be monitored are understood. IT governance is a critical component of corporate governance practices because of:

- the enabling capacity of IT for new service delivery models and changing government practices;
- the increasing value of information is being matched against the increasing costs of IT;
- the risks of providing services in an interconnected digital world and the dependence on third party suppliers and outsourcing service providers; and
- the impact of IT on business continuity due to increasing reliance on information and IT in all aspects of government.

4.6 Effective IT governance, which is critical to the success of most entities, assures that IT continues to deliver value and enables government service by:

- aligning IT with each entity's strategy;
- ensuring overall government strategies take proper advantage of IT investment;
- applying IT resources responsibly;
- levering IT for efficiency and productivity gains; and
- managing IT related risk appropriately.

IT process methodology

4.7 IT governance practices, including the IT control environment, are reviewed as part of the financial statement audits of entities to determine the extent of reliance that can be placed on them. Although ANAO's audits tend to focus on IT rather than ICT, IT governance processes equally apply to ICT. The ANAO has adopted an approach using maturity models[35] based on the Control Objectives for Information and related Technology model (CobiT)[36] for assessing the efficiency and effectiveness of sub-processes forming the overall IT processes

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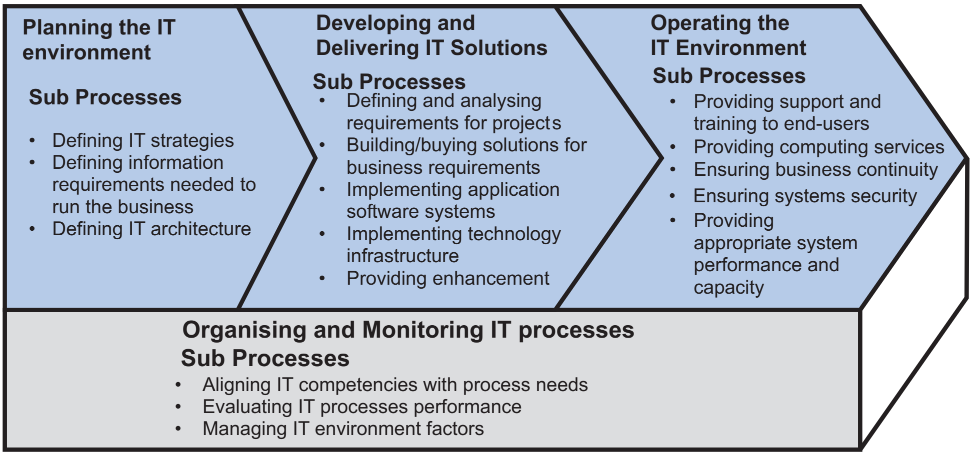
35 Maturity models—a method of scoring specific IT processes so that an entity can be graded from non-existent to optimised (0-5).

36 CobiT is a framework of internationally accepted standards that assists with the assessment of key aspects of an IT environment, as well as facilitating the understanding and management of information and IT risks. CobiT has been developed by the IT Governance Institute and Information Systems Audit and Control Foundation. (Refer to www.isaca.org for more information on CobiT).

of an entity. This assessment forms a fundamental guide to the setting of audit risk and the extent of specific audit testing to be undertaken.

Figure 4.1
ANAO's CobiT based IT Process Methodology



4.8 Figure 4.1 describes the IT process methodology used by the ANAO. Each of the sub-processes is documented according to the model to ensure that a sound understanding of IT processes is obtained. From this understanding, identified controls are then tested to confirm if they are operating effectively.

4.9 To evaluate how entities were performing against the ANAO CobiT based approach, maturity rating categories were developed to provide a benchmark for evaluating each IT sub-process in an entity. Table 4.1 provides an overview of the rating categories including a high-level generic description.

Table 4.1
CobiT based maturity rating categories and descriptions

Category	Detailed Description
Non-existent	There is a complete lack of any recognisable process.
Initial/Ad hoc	No standardised processes, but there are ad-hoc approaches. The entity recognises that issues exist and need to be addressed. Management is reactive in addressing any issues.
Repeatable but Intuitive	There is global awareness of issues. Processes are developed where they are repeatable and some of them begin to be monitored. There is no formal training and the communication on standard procedures and responsibilities is left to the individual. There is high reliance on the knowledge of individuals and errors are therefore likely.
Defined Process	Systems and procedures have been standardised, documented, communicated and implemented. Training and application of standards is up to the individual. The need to act is understood and accepted. Most processes are monitored against some metrics and deviations are acted upon mostly through individual initiative.
Managed and Measurable	There is full understanding of the issues at all levels. Responsibilities are clear and process ownership is established. A completed set of policies, procedures and standards have been developed, maintained and communicated and is a composite of internal best practices.
Optimised	There is an advanced and forward-looking understanding of issues and solutions. Processes have been refined to a level of external best practice, based on results of continuous improvements and maturity modelling with other organisations.
Explanatory Notes:	Assigned CobiT ratings given within this Report are based only upon assessment of systems related to the ANAO financial statement audits (i.e. revenue and payment systems). Any assessment that incorporates a broader whole of agency perspective, which includes non-financial business processes, could result in a different rating.

Source: CobiT Management Guidelines.

4.10 Progression through the rating categories means that IT processes are aligning more with the entity's organisational goals. This enables the entity to maximise benefits from its IT investment decisions, through deploying IT resources more effectively and through managing IT risks more appropriately.

4.11 In the public sector environment, the *Defined Process* maturity rating is the minimum baseline assuring appropriate IT governance arrangements are in place. There are exceptions, for example Government policy on information security requires security to be managed effectively, which indicate a *Managed and Measurable* rating may be more appropriate. In addition, for large entities which make strategic use of IT (and not for accounting purposes alone), a *Managed and Measurable* maturity rating may be more appropriate, indicating these entities are providing assurance about an appropriate return on their IT investment.

Audit focus

4.12 For the corresponding period last year, the ANAO undertook a broad review of IT governance arrangements across major entities. Overall, most entities were found to have defined processes over the planning of the IT environment, developing and delivering IT solutions, operating the IT environment and monitoring various IT processes. Some entities had further developed more mature processes in operating the IT environment and for monitoring and reviewing various processes. However for some entities, weaknesses were identified in IT systems security and business continuity management.

4.13 While the primary audit objective this year was to provide assurance about the general IT control environment as a part of financial statement audits of entities, secondary audit objectives were to:

- provide an understanding of the common issues facing entities and some practical considerations to help them improve the maturity of their IT governance arrangements;
- assess the integrity of the system environment, given that most entities have already established their core systems;
- identify the impact IT outsourcing arrangements had on the maturity of IT governance arrangements; and
- identify how IT governance areas are being handled by the larger entities.

4.14 The ANAO selected the IT governance areas, where processes had been previously identified as lagging in maturity, to provide a clearer focus on the improvements made during the period, or opportunities for further improvements. The ANAO, when reviewing IT operating environments, focused attention on whether entities had appropriate mechanisms in place to assure information security, business continuity management and change management practices, which provide the basis for ongoing information integrity, reliability and availability.

4.15 In addition, the ANAO performed a more in-depth analysis of these processes in five larger entities, namely the Australian Taxation Office; Centrelink; Department of Health and Ageing; Department of Veterans' Affairs; and Health Insurance Commission.

Overall Summary Assessment

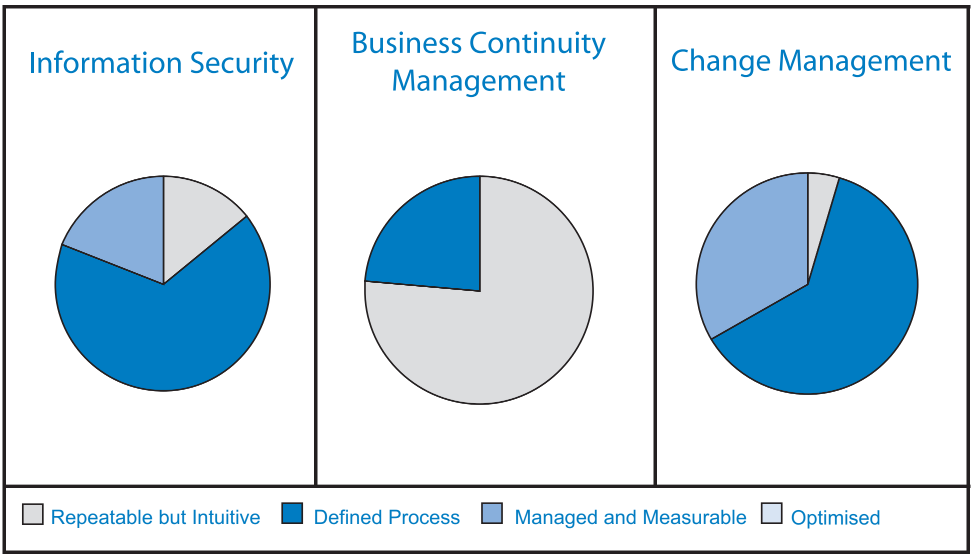
4.16 The following commentary details the results of IT interim audit testing of major entities (as set out in Chapter 6) for the period 1 July 2002 to 31 March

2003. It provides an overall summary assessment as to where entities are rated for information security, business continuity management, and change management.

4.17 Figure 4.2 shows most entities attained either a *Defined Process* rating or Managed and Measurable rating for their information security and change management practices. It also shows that most entities have business continuity practices below the *Defined Process* rating, the minimum baseline. Although information security and change management practices in some entities are below the baseline, the three practices reviewed are above the baseline in one or more entities. While the overall maturity of practices did not significantly vary between large and smaller entities, the achievement of specific information security maturity indicators did vary between these groups.

Figure 4.2

Maturity of information security, business continuity management and change management practices across entities



Information security

4.18 Information security provides the management processes, technology and assurance to allow the entities to be confident that their business transactions are valid and that their confidential information is withheld from those who should not have access to it.

4.19 The dependence on IT is increasingly making information security and the need for effective security governance critical to entity operations. Maintaining information security and integrity requires robust controls over the IT process that safeguards information against unauthorised use, disclosure or modification, damage or loss.

4.20 The ANAO focused on reviewing the security processes governing the IT environment. These included IT security policy, organisation, awareness, system access and security measures, security monitoring and remote access. The ANAO also specifically examined whether an appropriate level of logical security was being exercised over key financial systems. This included reviewing processes that ensure appropriate separation of duties, which prevent and detect unauthorised input or require change to financial systems and data.

Findings

4.21 Most entities attained a *Defined Process* rating for their information security practices. Figure 4.3 shows how entities performed against the individual maturity indicators for the *Defined Process* rating. Most entities recognise the fundamental importance of information security and demonstrated security awareness and have well-defined responsibilities and accountabilities. Prudent security policies exist and are used to reinforce security standards. The security polices are high-level documents that identify the roles and responsibilities of management, along with specifying expectations and processes to be followed. While there is visible support and commitment from executive management in most cases, only about half of the entities reviewed had either established current security plans or had specific security plans to protect business information in key business systems. While security policy is clearly defined strategically, more attention needs to be directed to information security planning across the respective entities and within key business applications.

4.22 Most large entities have established information security plans for some important business systems. Several smaller entities have an opportunity to improve their practices by gaining a better understanding of their specific security risks and establishing an information security policy, plan, and investigating security breaches and incidents.

4.23 Outsourcing of IT infrastructure under the cluster contract arrangements has generally had a positive impact on the maturity of security practices, with a clear definition of security controls being established. While most entities' outsourcing contracts adequately defined information security requirements, some contracts do not specify security governing outsourced equipment, agreed service level for security service provision, and protection from malicious software. In some of the smaller entities, contracts negotiated directly with third party suppliers of financial management, human resources management or infrastructure services do not adequately specify security requirements. These entities also tend to rely solely on the third party provider to ensure appropriate security practices are protecting their business data.

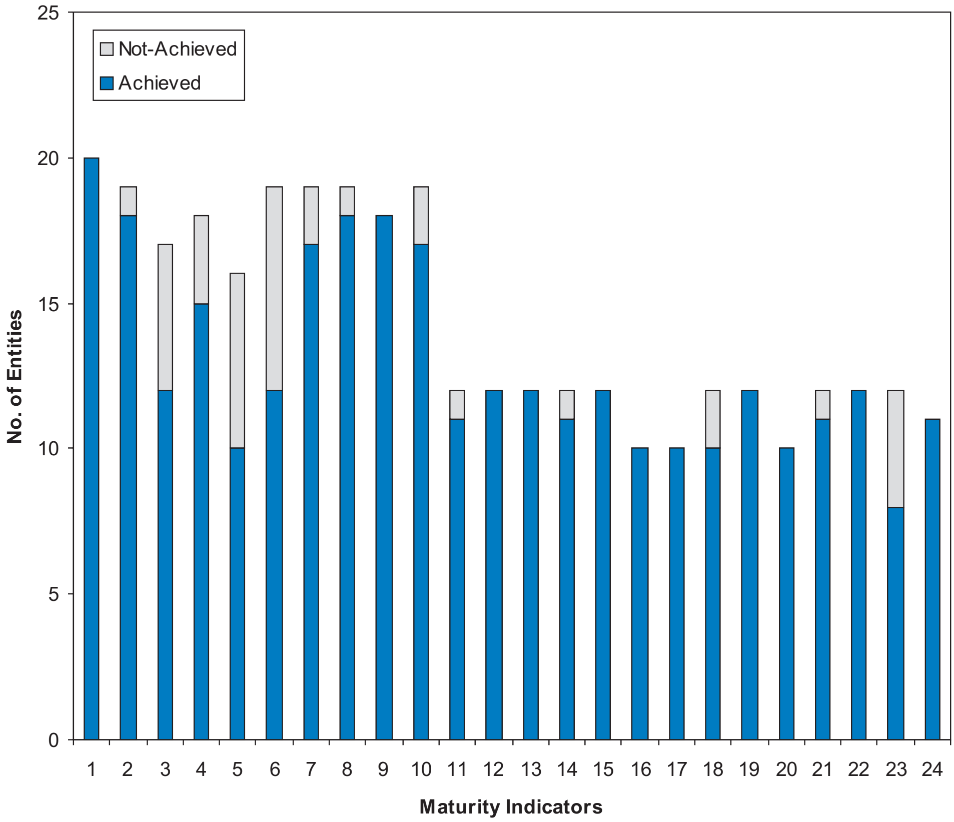
4.24 Figure 4.4 shows several entities have *Managed and Measurable* information security practices in place. Several more entities are making progress towards achieving this maturity level. The former entities have high security awareness where risks are understood; responsibilities are properly assigned; and policy and processes are actively managed. Security policy and physical security strategy are well integrated. Security breaches are reported and investigated. Approximately 30 per cent of entities reviewed are either establishing security certification for staff, including standardising user identification, authentication and authorisation processes, or undertaking regular security audits. Entities have the opportunity to improve their security practices by actively managing the security requirements specified in their outsourcing contracts.

4.25 Some entities attained a *Repeatable but Intuitive* rating for their information security practices. These entities can improve their practices by:

- establishing and implementing an approved information security policy;
- establishing information security roles and responsibilities;
- establishing security plans for their environment and key systems;
- promoting information security awareness and providing training;
- using password parameters that meet security best practice recommendations;
- reviewing access and password settings, especially for privileged users, regularly;
- developing standard user access profiles for each job function to ensure adequate separation of duties;
- enforcing procedures for the removal of users; and
- monitoring security logs and the network for security incidents and report, in a timely and regular manner.

Figure 4.3

Defined Process maturity for information security across entities



Maturity indicators:

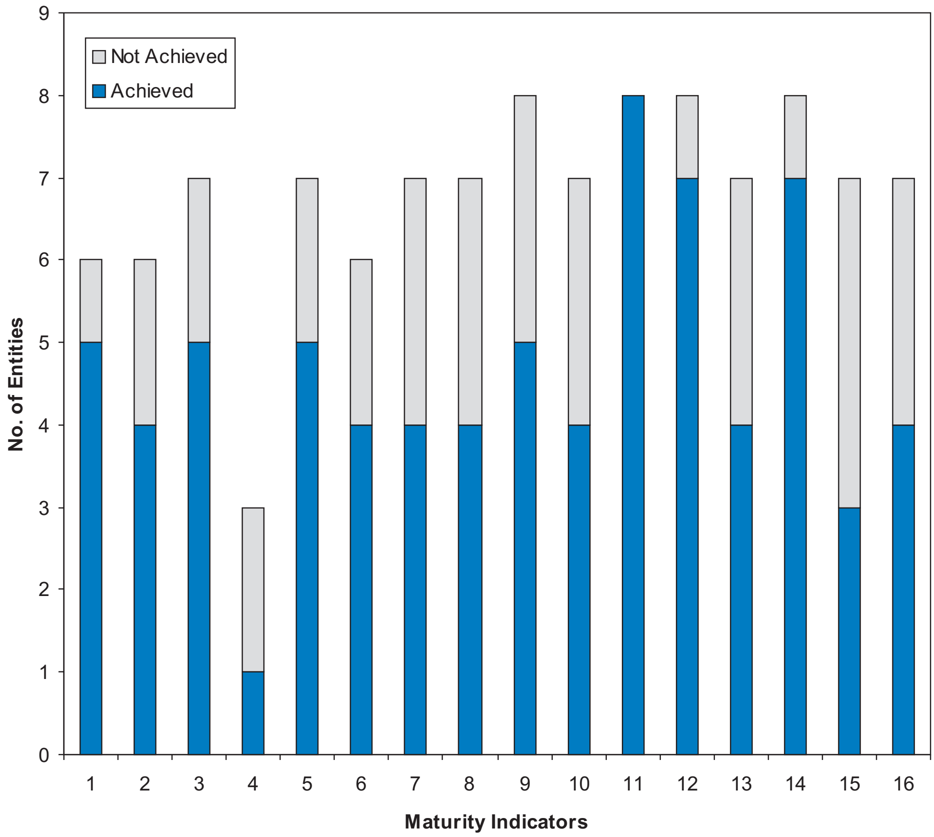
1. Executive responsibility is identified.
2. Operational responsibility is identified.
3. Entity security risks are understood.
4. Information security policy has been established.
5. Current information security plan exists.
6. Key systems have an information security plan.
7. Security awareness exists and is promoted.
8. Information security procedures are defined.
9. Information security reporting is IT focused, rather than business focused.
10. Information security breaches are reported.

Outsourcing contract addresses:

11. Entity's information security requirements.
12. General policy on information security.
13. How legal requirements are to be met.
14. How integrity and confidentiality are to be maintained and tested.
15. Access control agreements.
16. Right to monitor, and revoke, user activity.
17. User and administrator security training.
18. Protection from malicious software.
19. Investigation of security beaches and incidents.
20. How system access to sensitive information will be managed.
21. Security for outsourced equipment.
22. Responsibilities of all parties.
23. Service levels agreed for security.
24. Right to audit contractual responsibilities.

Figure 4.4

Managed and Measurable maturity for information security across entities



Maturity Indicators:

1. Responsibilities are clearly assigned, managed and actively enforced.
2. Operational responsibility for maintaining policy is assigned.
3. Security policies identify key goal indicators and information security practices identify key performance indicators.
4. Contractual security responsibilities are actively managed.
5. An information security committee exists and convenes at least quarterly.
6. Information security breaches and incidents are investigated and actively managed.
7. Information security performance is regularly reviewed and reporting is linked to business objectives.
8. Information security risk and impact analysis is consistently performed.
9. Intrusion testing is a standard and formalised process leading to improvements.
10. Information security processes are co-ordinated with corporate security.
11. Security certification of staff is being established.
12. User identification, authentication and authorisation are being standardised.
13. The information security plan is aligned with the corporate security strategy or arrangements. Security performance indicators are measurable.
14. Information security audits are undertaken regularly.
15. Security awareness briefings are conducted regularly and attendance by staff is mandatory.
16. Cost/benefit analysis of proposed security measures is being utilised.

Individual summary assessments for the larger entities reviewed in this report are provided below.

Australian Taxation Office

4.26 The ATO have developed well-defined security policies that have been approved by management. A branch has been established within the organisation with the primary focus of managing and facilitating IT security both internally and externally. The ATO also has clearly defined roles in relation to incident response and administration of the Local Area Network (LAN), mainframe and database environments.

4.27 Security awareness is prevalent at the ATO and is promoted strongly by management. A component of the employee induction program is a mandatory IT security training program, which emphasizes the importance of good practices in relation to security and privacy. The course is delivered to all new employees of the organisation. Additionally, training programs have been developed for a range of security topics and are delivered to target groups within the organisation.

4.28 The ATO has developed clear procedures for logical security of the IT systems including privileged access users. The procedures state the requirements in relation to who can authorise access, the password and user name structures and the monitoring of such access. Physical security at the ATO is evidenced by the use of proximity cards, electronic key pads, and security guards. Additionally, higher security areas make use of electronic surveillance including closed-circuit video.

4.29 The ATO has attained a *Defined Process* rating for their information security practices. Areas for improvement include ensuring that security reviews become more proactive, rather than reactionary, as this will assist in fostering a more secure environment.

Centrelink

4.30 Centrelink has an overarching IT security policy that provides the guidance and boundaries to establish sound security procedures. This policy covers all computing environments except that which relates to the Infolink (SAP) application.

4.31 Security administration is managed effectively through a process of centralised and localised activities with overall policy and operational security planning being developed centrally. All security policies have been considered by the Security and Privacy Committee, and based on its recommendation, endorsed by the Chief Executive Officer and the managers are responsible for ensuring that employees have access to the security policy; have an appropriate level of security awareness; and have clearances for the required level of information access.

4.32 IT security awareness is achieved through the distribution of IT security policies via the Intranet as well as with hard copy. While there is currently no formal training program for staff to increase awareness of IT security, Centrelink does provide security awareness training as part of its induction course.

4.33 Regular IT security audits are conducted which consists of both internal and external reviews.

4.34 Strong system access procedures are in place through the use of security access passes and/or electronic access tokens to approved persons. Access is only provided on the basis of demonstrated need. All employees' access to core business applications will be suspended for periods of leave in excess of five days.

4.35 System access and security measures are controlled though the use of the System Access Management System (SAMS) which governs authorisation, monitoring and management of user access.

4.36 The status of security within Centrelink is measured and reported to executive management against Australian and Government Standards. Monitoring of performance against these standards is achieved though annual security assessments, biannual 'Government Online' surveys, participation in Government incident and reporting arrangements, external certification, auditing, and internal security and privacy reviews.

4.37 Remote access to Centrelink resources is managed through remote access policies and procedures, encryption and specific purpose software. Remote access is only allowed for Lotus Notes and employees who work from home are responsible for the security of the material they are working on and are not allowed to access classified information unless certified by the Security Adviser.

4.38 Overall, Centrelink has attained a *Managed and Measurable* rating for their information security practices. This is considered to be an appropriate level given the nature of Centrelink's operations. For example, it is possible to monitor and measure compliance with security procedures and to take action where processes appear not to be working effectively. Responsibilities for governmental policy implementation and standards are clearly assigned, managed and actively enforced. Information security performance is regularly reviewed and reporting is linked to business objectives. Improvement could be made, however, through the development of a policy and procedure document for established practices that govern security surrounding Centrelink's Infolink application.

Department of Health and Ageing

4.39 IT security roles and responsibilities are managed and measurable with government policy and standards for information security being clearly assigned, managed and enforced. A branch has been established within the organisation with the primary focus of managing and facilitating IT security. The Department also has clearly defined roles in relation to the administration of the Local Area Network, mainframe and database environments.

4.40 There is an overall awareness of information security within the Department. Information security policies and standards are published on the Department's Intranet. All staff must sign the security and privacy clause on the IT access request form when applying for access to the Department's information systems.

4.41 Regular information security audits are undertaken by Internal Audit and Health Security functions.

4.42 The Department has established user access management procedures to ensure user access permissions are appropriately approved and reviewed on a regular basis. However, the Department does not have effective processes in place to ensure that terminated employees have their access to information systems removed on a timely basis.

4.43 System security measures are formally documented in the various Security Plans for operating systems. However, management has not performed information security risk assessments for each critical business application to ensure that security measures adequately meet business requirements.

4.44 The security monitoring and investigation procedures are adequate. In addition, responsibilities for performing this function are well defined between the Department and the outsourced provider of technology infrastructure, IBM-GSA.

4.45 Remote access is governed by adequate policies and procedures. The use of encryption and a specifically required software load set, ensure managed access to Health resources.

4.46 Overall, the Department has attained a *Defined Process* rating for their information security practices. One area for improvement is to establish adequate procedures to ensure network and application access for terminated employees is disabled on a timely basis.

Department of Veterans' Affairs

4.47 The Department has developed IT security policies that are sufficiently detailed to identify responsibility for enforcing the policies, the expectation of system owners and users, and the consequences of security breaches. The IT security policy is used as the core policy document to promote security awareness, processes and solutions throughout the Department. Business owners are responsible for developing and maintaining appropriate security plans for business applications that are consistent with the IT Security Policy; identify risks specific to that application; and that implement adequate security controls.

4.48 Security considerations are recognised as integral to major system upgrades and system implementation acquisition. Risk assessments and identification of appropriate controls for all new IT applications development, infrastructure or system upgrades are adequately performed.

4.49 The Department's governance arrangements include assurance services provided by Internal Audit. In the last year, Internal Audit has performed a number of security and risk management related activities.

4.50 The Department's Security Awareness program consists of a mandatory IT security training program. The program appropriately addresses security and privacy practices required by the Department and is part of the induction process for new employees. The course has been delivered in state offices with attendance tracked, and followed up, where necessary.

4.51 Security management is retained within the Department and is the responsibility of the Department's Information Management Unit—IT Infrastructure Section. The IT Security Sub-Section is responsible for administering system access for all staff, including staff of the outsourcing firm.

4.52 The Department has adequate controls that allow it to detect security events, as well as to log and take appropriate action where required. User activity is logged and reviewed by the Department's IT Security Sub-Section on a daily basis. Security matrices have been developed in accordance with ACSI 33[37] for all key systems.

4.53 Physical security at the Department is evidenced by the use of proximity cards, electronic key pads, and security guards. Additionally, higher security areas have electronic surveillance including closed-circuit video.

4.54 The Department has attained a *Defined Process* rating for their information security practices. Areas for improvement include:

- strengthening controls to mitigate the risk of 'cloning' user access;

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[37] ACSI33—Australian Communications—Electronic Security Instruction. ACSI33 has been written to be consistent with the Protective Security Manual. Developed by the Defence Signals Directorate (DSD) to provide guidance to Australian Government agencies wishing to protect their information systems.

- strengthening the controls around the timely notification of employee's termination of employment to IT Security and other security personnel; and
- update the IT Security Policy to reflect current security practices and ensure that all key security plans are updated and reviewed on a regular basis.

Health Insurance Commission

4.55 The Commission has defined IT Security roles and responsibilities. All staff are required to attend IT security awareness training and to have a level of security clearance. IT security audits are performed on a regular basis. However, the IT security policy is outdated. Steps are being undertaken to update it, but this is proving to be a time-consuming task. Unique user IDs and passwords are required to access all key business applications. The IT outsourcer conducts security monitoring. However, no defined procedures exist for the Commission to monitor security incidents. Reviews of security reports are not yet being performed.

4.56 Mainframe security administration processes and settings were found to be inadequate and could not be relied upon for the purposes of designing test procedures for the financial audit. Remote access to the Commission information systems is not available to users at this time.

4.57 Overall, the Commission has attained a *Repeatable but Intuitive* rating for its information security management practices. Areas for improvement include the:

- update of the information security policy;
- implementation of stronger user administration controls and security settings over the mainframe; and
- implementation of security monitoring procedures over the mainframe.

Business continuity management

4.58 Information availability through continuous service delivery is dependent upon information and supporting IT infrastructure being available to authorised staff to support decision-making and service delivery processes when required. Maintaining information availability requires controls to counteract interruptions to business activities and to protect critical business processes from the effects of major failures, disasters or deliberate attack.

4.59 In line with the Government's *Domestic Counter Terrorist Arrangements,* inter-Australian Governments counter terrorism cooperation has produced the

Critical Infrastructure Security Notification Model released in January 2003. This provides generic guidelines for minimum-security considerations, including business continuity requirements, to be implemented against various counter-terrorism alert levels, in accordance with the National Counter-Terrorism Plan. The term critical infrastructure refers to infrastructure, which if destroyed, degraded or rendered unavailable for an extended period, will significantly impact on social or economic well-being or affect national security or defence. In this model, the development of a business continuity plan is a key requirement for all security alert levels.

4.60 The ANAO focused on reviewing business continuity management practices which included:

- business continuity plans and processes that ensure business operations would continue to operate (in some capacity) in the event of disaster, until such time as the system is reinstated; and
- the disaster recovery plan and processes that ensure the IT system is re-instated to a satisfactory operating level.

Findings

4.61 Most entities attained a *Repeatable but Intuitive* rating for their business continuity practices. Figure 4.5 shows how entities rated against the individual maturity indicators for the *Repeatable but Intuitive* rating. Many of the entities reviewed either have no business continuity plan, or are in the process of developing one, indicating that many entities have an awareness of business continuity management. However, their ability to recover from a disaster may be limited.

4.62 Figure 4.6 shows how entities rated against the minimum baseline *Defined Process*, for business continuity management. Although most entities have assigned executive responsibility, only about 30 per cent of entities reviewed have a business continuity plan, disaster recovery plan or use high availability equipment to deal with the threat. For some entities, where business continuity plans and disaster recovery plans exist, there is insufficient scope or detail in the plans to be able to conclude confidently that they could recover from a disaster. In addition, some of these entities have not tested these plans to ensure that they can recover from a disaster. Most entities have the opportunity to improve their practices including gaining a better understanding of their specific risks and business impact, assigning operational responsibility, establishing quality business continuity plans and disaster recovery plans, and performing follow-up reporting on progress.

4.63 The maturity of business continuity processes was consistent across large and small entities.

4.64 Outsourcing of IT infrastructure did not have a strong influence on improving the entities' business continuity management practices and, in some cases, may hinder maturity. Given the responsibility for business continuity resides in the entity, the outsourcers' focus is on the IT disaster recovery planning. However, the outsource providers generally do not have sufficient knowledge of the entity's business requirements and risk, and often have no contractual obligation to do so. Audit findings indicate that, in some instances, outsourcers have developed disaster recovery plans without reference to the entity's unique business requirements, risks and business systems. These findings indicate that entities need to be extremely mindful of assuming the outsourcer has sufficient measures in place to assist them in the event of a disaster. Entities need to maintain the responsibility for disaster recovery and establish more clearly defined relationships with their outsourcers to ensure they are both aware of the business continuity risks. Furthermore, many contract agreements reviewed do not clearly articulate what is required in the disaster recovery plan, hence explaining the lack of detail found in some disaster recovery plans. As well, they do not specify the entities' specific risk and agreed service levels for business continuity management.

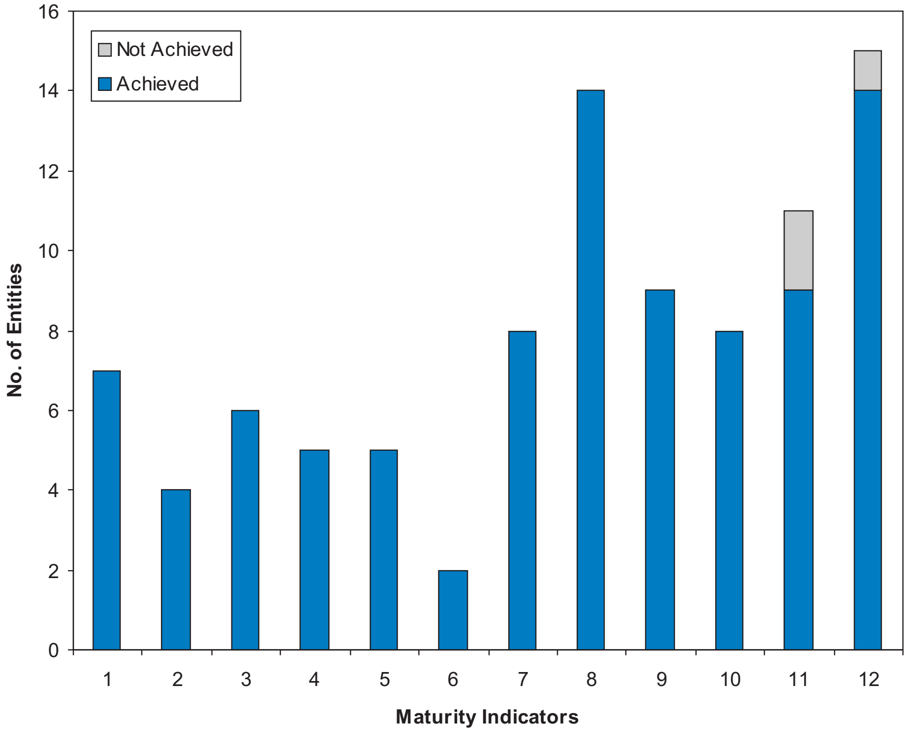
4.65 Most entities can improve their maturity rating by:

- establishing agreed service continuity objectives and priorities covering all business functions;
- undertaking a risk assessment to identify all specific corporate and IT risks threatening business continuity;
- establishing a quality business continuity plan and disaster recovery plan to meet corporate objective and priorities, compliant with ANAO's Better Practice Guide *Business Continuity Management: Keeping the wheels in motion*, January 2000;
- establishing a quality disaster recovery plan that includes all of the entity's critical sites, infrastructure (including telephony) and applications, their recovery priority, maximum acceptable outage, estimated time to recovery, and costing for implementation;
- assigning operational responsibility for training, testing and activating and coordinating business continuity management plans;
- promoting awareness of, and providing training in, continuity management;

- reviewing and testing business continuity and disaster recovery plans regularly;
- advising their IT infrastructure outsourcer of their business continuity plans;
- specifying disaster recovery service levels, which are consistent with defined business continuity service levels;
- ensuring the correct prioritisation of their applications comparative to other entity's applications, within cluster outsourced contract arrangements;
- specifying service levels required during a disaster scenario in relevant outsourcing (and/or third party supplier) contracts; and
- managing the IT outsourcer's (and/or third party suppliers) disaster recovery contractual obligations.

Figure 4.5

Repeatable but Intuitive maturity for business continuity management across entities

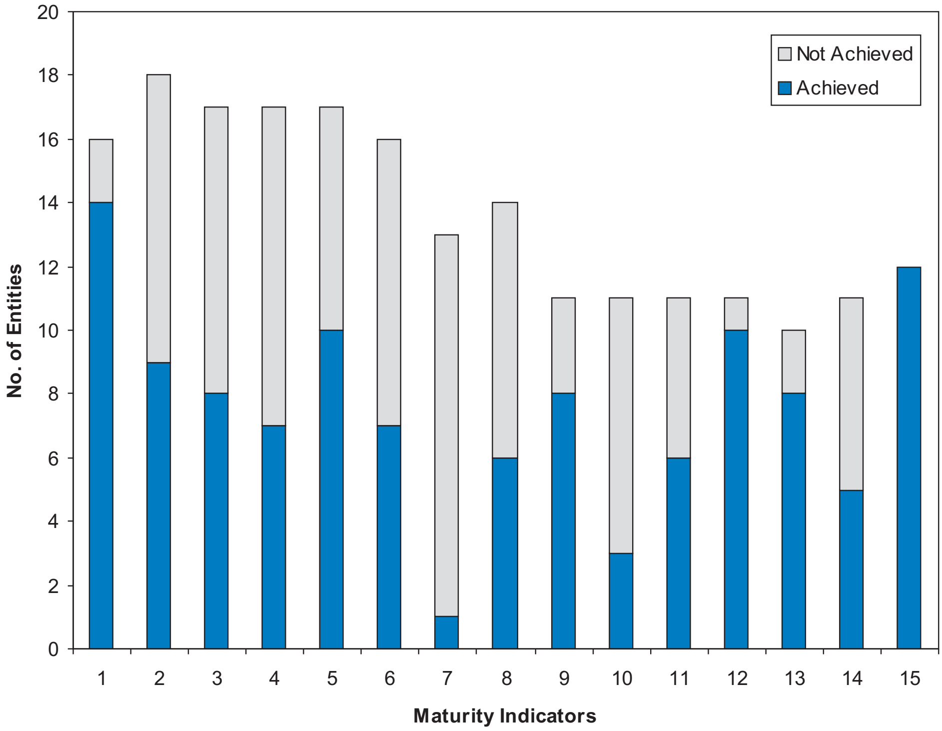


Maturity Indicators:

1. Management is becoming aware of the risks related to continuous service.
2. Management is becoming aware of the risks related to disaster recovery.
3. The focus is on the IT function, rather than on the business function.
4. Users are implementing work-arounds.
5. The response to major disruptions is reactive and unprepared.
6. Planned outages are scheduled to meet IT needs, rather than to accommodate business requirements.
7. Responsibilities for continuous service are informal or have been identified.
8. The approaches to continuous service are fragmented.
9. Reporting on system availability is incomplete and does not take business impact into account.
10. There are no documented continuity plans, although there is commitment to continuous service availability and its major principles are known.
11. A reasonably reliable inventory of critical systems and components exists.
12. Standardisation of continuous service practices and monitoring of the process is emerging, but success relies on individuals.

Figure 4.6

Defined Process maturity for business continuity management across entities



Maturity Indicators:

1. Executive responsibility is identified.
2. Operational responsibility is identified.
3. Specific risks to the Entity are understood.
4. A current Business Continuity Plan exists.
5. A current Disaster Recovery Plan exists.
6. The Disaster Recovery Plan includes the Entity's critical systems and business impact.
7. There is periodic reporting of business continuity management where individuals take the initiative for following appropriate policy and practices.
8. Executive management communicates consistently the need for continuous service.
9. High—availability service and equipment components are being applied piecemeal.

Outsourcing contract addresses:

10. Entity's risk of disaster or security failures, identifies business impact and business priorities.
11. Entity's business continuity management requirements.
12. Disaster recovery responsibilities of all parties.
13. How the availability of services are to be maintained in the event of disaster or security failure.
14. Service levels agreed for business continuity management.
15. The right to audit contractual business continuity management responsibilities.

4.66 Individual summary assessments for the larger entities are provided below.

Australian Taxation Office

4.67 In 2001–2002 the ATO undertook a risk assessment of business continuity planning which resulted in a change to the methodology employed. This methodology is part way through implementation and as such business continuity plans are in the process of being developed and approved.

4.68 Over the past year, the ATO has focused considerable resources on their business continuity management, including the implementation of appropriate tools and methodology, as well as the development of a disaster recovery plan for the mainframe environment. Whilst considerable work has been undertaken, the ATO still needs to implement formal policies and standards; complete testing of its business continuity and disaster recovery plans; and develop, implement, and test a disaster recovery plan for the midrange computing platforms as planned.

4.69 Outsourcing contracts for the mainframe address key business requirements. However, the IT infrastructure contract specifies that agreed service levels do not apply in the event of a disaster.

4.70 The ATO has attained an *Repeatable but Intuitive* rating for their business continuity practices. However, the ATO is aware of their business continuity management weaknesses and has implemented plans to address the shortcomings.

Centrelink

4.71 Formal disaster recovery and business continuity plans have been developed as part of the Centrelink business continuity framework. This framework includes assessment of critical activities, consideration of disaster scenarios, development of crisis plans for specific business areas and regional areas, disaster notification procedures and responsibilities of management. The framework requires the business continuity plan to be developed after an appropriate risk assessment. A formal risk management framework has been developed and is currently in the process of being implemented.

4.72 Business continuity plans have been developed for key areas and offices within Centrelink. A business continuity plan template was provided to all areas to assist them in developing their own plan and defining key areas requiring completion. These plans are maintained centrally on a Lotus Notes database. They are all currently undergoing testing and are being managed, reviewed and tested by the Business Continuity Team.

4.73 A disaster recovery plan exists to ensure Centrelink can recover when necessary. The communication of roles and responsibilities in the disaster recovery plan is clearly defined for all staff levels, departments, offices, facilities, functions and business areas. Given Centrelink's highly complex and heavily integrated IT framework, two computer sites are currently maintained. One is located in Bruce and the other in Tuggeranong, Canberra. The recent Canberra fire storm may necessitate a revision of the risk profiles of the two computer sites.

4.74 Centrelink conducts disaster recovery testing for the mainframe platform every quarter. A typical disaster recovery test involves simulating the loss of one of the data centres and recovering to the alternate site. This testing not only tests the operational procedures, but also provides assurance of Centrelink's ability to recover.

4.75 Nightly backups are performed on system files and stored on a specific backup server. The Storage Access Network System backs up all PCs on the network automatically. Information coded and saved at the local site each day is backed up at the Area Office. The IT support centre monitors these backups and is responsible for the restoration of backup files.

4.76 Scheduled backups for the Canberra Data Centre are performed. Hourly backups are made of data files. This ensures that in the event of a system failure, the data files can be restored to a state held prior to the failure, without the introduction of errors, and without too much data re-entry. Off-site storage of data centre backups is undertaken. These procedures are the same for the Bruce Data Centre.

4.77 Overall, responsibility for maintaining business continuity and disaster recovery planning is assigned and the associated processes are being tested. The results of tests are gathered, analysed, reported and acted upon and service redundancy practices are being consistently deployed. Centrelink's has attained a *Defined Process* rating for their business continuity management. However, improvements could be made in linking the various business continuity plans with an overarching business continuity plan for Centrelink and actively managing and providing training to staff on business continuity and disaster recovery processes.

Department of Health and Ageing

4.78 Management have made steps towards assessing business risks associated with business continuity management. However, the Department does not yet have a department-wide business continuity management plan.

4.79 Management have implemented a disaster recovery plan for the mainframe environment. However, formal disaster recovery plans for other critical IT infrastructure and applications have not yet been developed.

4.80 The Department does not have a formal crisis management plan. However, in the recent bushfire disaster in Canberra, management have shown that they have been able to respond in crisis mode.

4.81 Overall, the Department has attained an *Repeatable but Intuitive* rating for their business continuity management practices. Management are aware that the current practices require formal development and have undertaken a risk assessment to facilitate the development of adequate business continuity and disaster recovery plans.

Department of Veterans' Affairs

4.82 A business continuity plan has been developed by DVA that covers all functions of the Department including IT systems and infrastructure. The plan is the responsibility of the Division Head of the Corporate Development Division. It was last updated and approved by management in July 2002.

4.83 The business continuity plan identifies key systems and essential services along with the maximum outages (acceptable period of time) of each. Contingency plans have been established with work-around solutions for core business and IT functions, such as the continuance of pension payments to veterans in the event of system failure.

4.84 The Department has appropriate backup and recovery procedures in place. The Department has reviewed the existing procedures in late 2002 to confirm that the outsourcer (IBM-GSA) is meeting the Department's backup and recovery requirements. The backups are stored offsite for a period of two months.

4.85 The Department has attained a *Defined Process* rating for business continuity management. Weaknesses identified with the current business continuity planning include the lack of a formalised disaster recovery plan or disaster prevention plan and the need for the Department to ensure that maximum outages identified in the business continuity plan are consistent with contract arrangements.

4.86 The Outsourcer has core responsibility for continuity of infrastructure services. The Department does not subscribe to IBM-GSA's disaster recovery services, however the outsourcing contract stipulates that IBM-GSA will endeavour to restore services within 14 days. The risk to the Department is that the maximum acceptable outages defined in the current business continuity plan are inconsistent with the current agreement with IBM-GSA. The Department has reduced its operational risk by ensuring that appropriate Service Level Agreements were built into the previous contract. The Department has acknowledged that the current business continuity plan needs to be updated to reflect the new agreement with IBM-GSA.

4.87 In the absence of such a formalised plan there is the potential, in the case of a disaster, that systems and applications would not be recovered in a timely and organised manner to meet the Department's business objectives. The Department's Disaster Recovery process is rated as *Repeatable but Intuitive*.

4.88 The Department has subsequently advised the ANAO that the Information Management Unit has escalation and notification procedures designed to ensure speedy recovery of its systems and applications. These procedures will be assessed as part of the next audit cycle.

4.89 Areas for improvement include clarifying the existence of a current, updated, formalised and tested disaster recovery plan to ensure the Department has service continuity in the event of a disaster or significant outage.

Health Insurance Commission

4.90 The Commission last implemented disaster recovery plans in 1999 and had not actively kept these plans up-to-date and have not tested them since their development. Management has recently focused on assessing business risks associated with business continuity and progressed significantly towards developing business continuity management practices in alignment with best practice. However, the Commission has not yet fully implemented and tested a comprehensive business continuity plan in line with best practice.

4.91 Management has implemented a disaster recovery plan for the mainframe environment. However, this plan has not yet been fully tested.

4.92 Currently, the disaster recovery strategy and the supporting technology infrastructure are being revised to align with best practice. This project is due for completion in calendar 2003. The current disaster recovery plan has not been tested since the technology infrastructure was outsourced a number of years ago.

4.93 Overall, the Commission has attained a *Repeatable but Intuitive* rating for their business continuity management practices. Management is focusing resources on this area of risk. They have significantly progressed towards developing business continuity and disaster recovery plans, and have planned for the testing of these plans in alignment with best practices in the near future.

Change management

4.94 Information reliability and integrity is dependent on system and IT infrastructure changes being controlled and integrated into the production environment in a systematic and controlled manner. Also, unauthorised or ad hoc changes to business systems and supporting IT infrastructure, (including the PC, server and networking environments), impact on an entity's ability to provide critical information services. Maintaining integrity requires controls that ensure all changes are planned, scheduled, applied, tested, accepted, distributed, and tracked.

4.95 The ANAO focused on reviewing the change management processes including:

- management over software and infrastructure inventory items;
- change initiation and approval, modification, development, testing and implementation; and
- emergency changes.

Findings

4.96 Most entities attained a *Defined Process* rating for their change management practices. Figure 4.7 shows how entities rated against the individual maturity indicators for the *Defined Process* rating. Most entities provide management leadership and operational support. They have also established an appropriate committee to govern well defined procedures covering the change cycle, including impact analysis and problem and incident reporting.

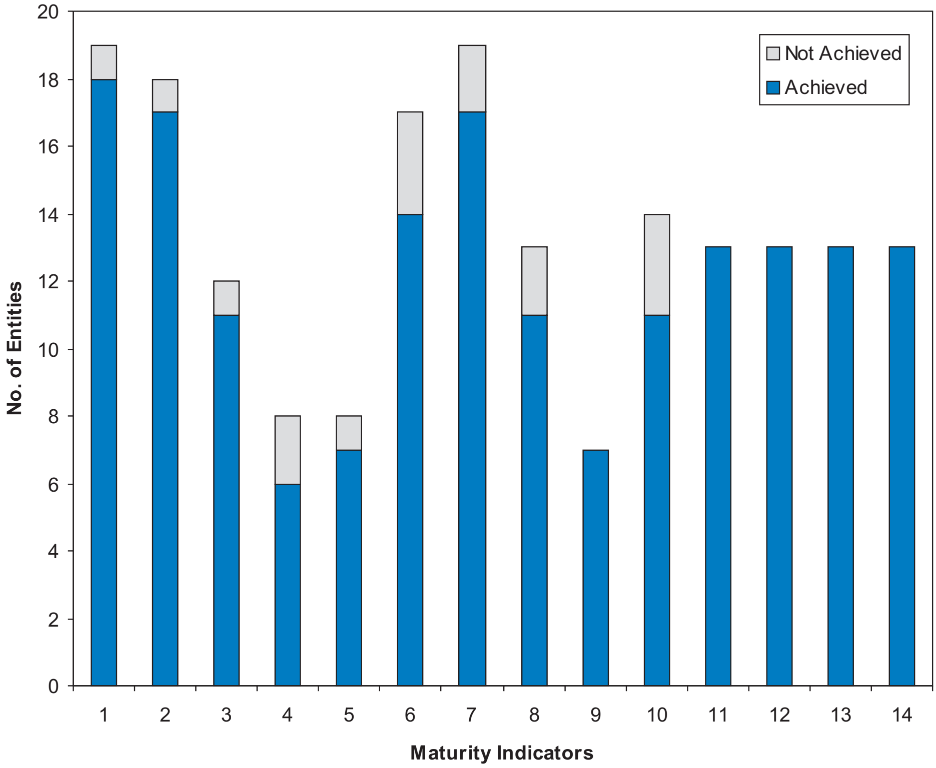
4.97 Outsourcing generally improved the change control practices. This could be due to the linkage between changes in the IT environment to the outsourcers' billing process. Also, most contracts reviewed adequately define change management requirements.

4.98 Figure 4.8 shows several entities have *Managed and Measurable* change management practices in place. Several more entities are making progress towards achieving this maturity level. However, approximately 50 per cent of entities reviewed did not have change performance indicators that are regularly reviewed and reporting linked to business objectives.

4.99 Some entities attained a *Repeatable but Intuitive* rating for their change management practices. These entities can improve their practices by formally documenting corporate change management policies and actively monitoring and reporting on the compliance with these policies.

Figure 4.7

Defined Process maturity for change management across entities



Maturity Indicators:

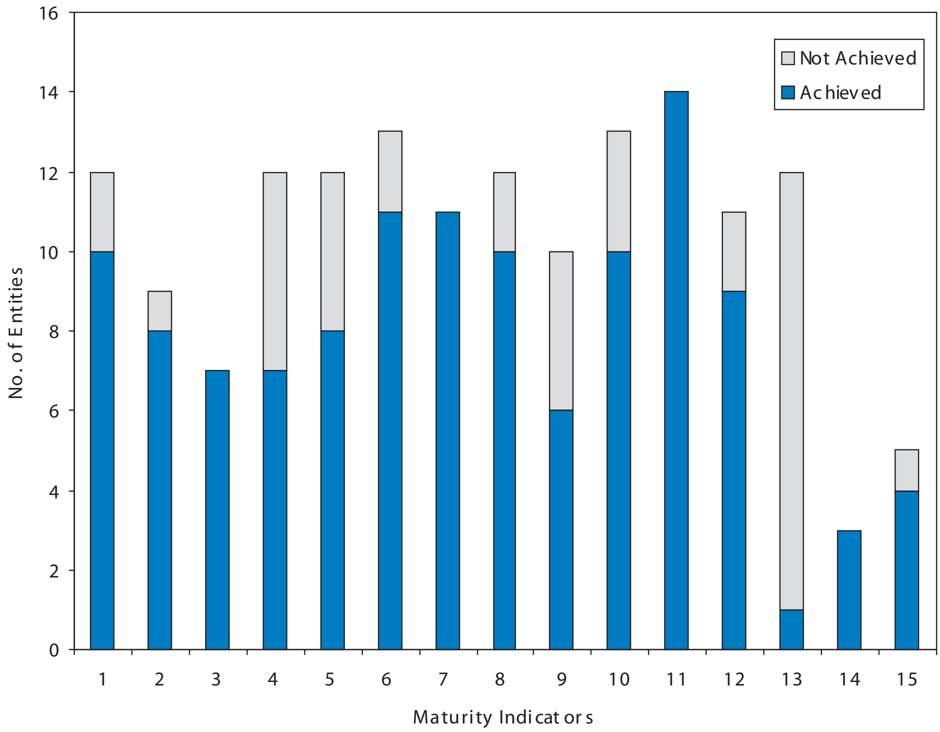
1. Management responsibility is identified.
2. Operational responsibility is identified.
3. Change management processes are in place, but compliance is not enforced.
4. The defined change management process is not always seen as practical and processes are bypassed.
5. A Configuration Management Plan exists.
6. The analysis of the impact of IT changes on business operations is becoming formalised.
7. Problem and incidents resulting from changes are reported.
8. The need for accurate and complete configuration information for the IT infrastructure is understood and enforced.
9. Configuration management data is being used by change, problem, incident and release management processes.
10. The need for an effective problem management system is accepted and evidenced by appropriate budget support.

Outsourcing contracts specify:

11. Clear and specified process for change management.
12. Change management responsibilities of all parties.
13. Service levels agreed for change management.
14. Right to audit contractual change management responsibilities.

Figure 4.8

Managed and Measurable maturity for change management across entities



Maturity Indicators:

1. Responsibilities are clearly assigned, managed and actively enforced.
2. Operational responsibility for maintaining processes is assigned.
3. Contractual change management responsibilities are actively managed.
4. Change management is becoming more integrated with changes in the business processes.
5. The change management process is well developed and consistently followed for all changes and management is confident that there are no exceptions.
6. Change management documentation is current and correct, with changes formally tracked.
7. The change management process is efficient and effective, but relies on considerable manual procedures and controls to ensure quality is achieved.
8. A change management committee exists and convenes at least quarterly.
9. Cost/benefit analysis, supporting the requested business application changes, is increasingly being utilised.
10. All changes are subject to thorough planning and impact assessment.
11. An approval process for changes is in place.
12. The majority of problems and incidents resulting from changes are investigated.
13. Change management performance indicators are regularly reviewed and reporting is linked to business objectives.
14. The need to manage the configuration is recognised at all levels of the Entity.
15. Change management processes are integrated with inventory management.

4.100 Larger entities generally have more developed practices than the smaller entities. Individual summary assessments for the larger entities are provided below.

Australian Taxation Office

4.101 The ATO has a clearly defined change management process that has management involvement and sign off at several levels. This process is highly integrated with configuration management and adequately addresses key infrastructure and security requirements.

4.102 The process is based upon project-based management of all changes other than emergency fixes or minor production errors that can be rectified within 15 days. Project based changes are initially scoped, prioritised, costed and then assigned to discrete projects. They are then managed by a central project manager through the functional specifications, coding and testing phases.

4.103 All changes are tracked through a central SOLVE error management system and are reported upon regularly by the various project managers and associated committees.

4.104 All of the above processes, including the emergency fixes, are adequately documented and are actively enforced.

4.105 Overall, the ATO has attained a *Managed and Measurable* rating for its change management practices.

Centrelink

4.106 Change management within Centrelink is well maintained and documented through an approved project and software development methodology called 'The Red Book'. Detailed procedures are provided to all staff which outlines the process and requirements of change control.

4.107 Accountability and performance is maintained through the requirement of signing a Financial Management and Accountability (FMA) certificate that indicates that the signatory has reviewed the performance of the change and agrees that the change has undergone the required process. This process is presented as a FMA Product Assurance Process pro-forma, which is a checklist to ensure that the deliverables required to satisfy the quality requirements in the development of any system, or application change have been created and appropriately stored in corporate records. This certificate is required prior to any release of a change into the production environment. The Change Control Board reviews changes that are considered significant or major.

4.108 Following each quarterly change release, a report to the Chief Information Officer is prepared on the level and quality of compliance. There are also random compliance audits on the FMA certification process where written feedback is provided to the change management team supplying information about the quality of the documentation and compliance with requirements.

4.109 Changes have been categorised into three areas: major, minor and emergency. Changes scheduled for release are communicated in both IT Events (Change management tool for tracking changes) as well as via the Intranet. Records are maintained in accordance with required legislation. Also backups are retained on tape to allow restoration of data at a point in time should data files fail.

4.110 Change initiation and approval is undertaken through the authorisation of a new work request form. This is undertaken by way of an IT Work Assignment Warrant which provides the necessary authorisation and approval. Development, testing and production are all segregated environments with unique users, and programs. Changes are migrated from one environment to the next by personnel independent of the change.

4.111 Emergency changes undergo the same procedures as all other changes. However, they are fast tracked through the approval process which allows the appropriate documentation to be created and maintained for review. The Change Control Board reviews the changes that are to be released and assigns them the status of 'emergency'.

4.112 Overall, Centrelink has attained a *Defined Process* rating for its change management practices. Change management procedures have been standardised and documented. However, it is left to the individual to follow these procedures. The audit revealed that there is a defined formal change management process in place, including categorisation, prioritisation, emergency procedures, change authorisation and release management. However, compliance is not always enforced.

4.113 Centrelink will need to ensure that management of their change process is further strengthened and focused on compliance monitoring. To do this, management must ensure that compliance with the change control procedures are strengthened to provide assurance over the integrity of changes and systems. Management should enhance the registration tool for the initiation, monitoring and tracking of all modifications to any IT related resource. Training programs also need to be enhanced and provided to all staff involved.

4.114 It is understood that Centrelink has already commenced improving its change management frameworks by revising its change management processes to follow the IT Service Management (ITSM) framework.

Department of Health and Ageing

4.115 The Department has a formal systems development methodology and quality control framework in place. However, ANAO noted that this process is not followed for all systems developments and would enhance controls over systems development if it was implemented Department-wide.

4.116 Testing on major business applications confirm that these procedures are generally being followed.

4.117 Change control procedures for major business applications are formally established. Testing confirmed those procedures are being followed. However, change control processes for other applications are less formal and could be enhanced.

4.118 Each application has its own problem management process as appropriate. The formality and strength of this process depends largely on the size and complexity of the application.

4.119 IBM-GSA has a formal problem management procedure relating to outsourced infrastructure. The performance of this process is monitored and measured by the Department in accordance with a formal service level agreement. In addition, the Department's Technical Environment Change Control (TECC) Committee must approve all changes.

4.120 Incident management responsibilities are appropriately defined and shared between the Department and IBM-GSA. IBM-GSA is responsible for infrastructure related incidents and Health is responsible for application incidents. In addition, there is a defined notification and reporting process if IBM-GSA identifies incidents.

4.121 Overall, the Department has attained a *Defined Process* rating for their change management. Areas for improvement include requiring all Health IT development projects to comply with the IT systems development methodology and quality control framework. Compliance should also be extended to all outsourced projects. The methodology should be scaleable based on size and risk to ensure effective and efficient application of the framework. In addition, the related user manuals and documentation should be updated to reflect changes in system functionalities.

Department of Veterans' Affairs

4.122 The Department has a clearly defined and documented change management process. Within this process there are clearly defined approval steps including approval from relevant business representatives and key milestones that must be met.

4.123 IT Governance arrangements include the Change Control Committee, which meets regularly to consider and schedule requests for changes to the IT environment. The Committee consists of representatives from both the outsourcer and the Department's Information Management Unit. Roles and responsibilities are clearly defined and reflected in policy, procedures and outsourcer's service level agreements.

4.124 The Department has an established project management methodology called the Rapid Delivery Method that is used in conjunction with the standards of the quality management system. Guidance and documentation on the methodology are available both via the Intranet and the TRIM document management system. As part of this process threat and risk assessments are undertaken for all major changes to existing systems or new applications.

4.125 The Department has systems in place to log, monitor, approve and track changes prior to implementation in the production environment.

4.126 The Department has reduced the risk associated with emergency changes by ensuring that the same change management procedures required by normal changes are applied to emergency changes. As part of the process escalation contacts are clearly identified and the use of Emergency user ids via the 'Firecall' utility are logged and reviewed daily by IT Security. All 'Firecall' documentation is retained by IT Security.

4.127 Overall, the Department has attained a *Managed and Measurable* rating for their change management practices.

Health Insurance Commission

4.128 Responsibilities, policy and methodology for change management including configuration, problem and incident and release management, are clearly assigned, managed and actively enforced. Further, operational responsibility for maintaining change management methodology and procedures and problem and incident and release management is assigned.

4.129 The analysis of the impact of IT changes on business operations is becoming formalised, to support planned rollouts of new applications and technologies.

4.130 Problems and incidents resulting from changes are reported. In addition, maintenance activities take into account lessons learnt from previous problems and incidents. The majority of problems and incidents resulting from changes are investigated; analysed for continuous improvement opportunities; and actively managed under the governance of the Technology Change Committee.

4.131 IT change management planning and implementation is becoming more integrated with changes in the business processes to ensure that, through training, organisational changes are addressed.

4.132 Whilst a common approach is used for change management throughout the organisation, slightly different methodologies are used to perform the change management process for some applications. Management is currently undergoing a process to roll out a common methodology for all applications to improve the control environment over change management.

4.133 Overall, the Commission has attained a *Managed and Measurable* rating for its change management practices. Controls can be improved in this area by establishing a standard change control methodology for all applications.

Conclusion

4.134 Interim audit results for 2002–2003 indicate most entities have attained a *Defined Process* rating, a minimum public sector baseline, for their information security and change management practices. In addition, several entities had further developed more mature practices and attained a *Managed and Measurable* rating for their information security and change management practices. These entities are beginning to maximise the return on their IT investments by deploying IT resources more effectively and managing IT risks more appropriately.

4.135 However, most entities attained an *Repeatable but Intuitive* rating for business continuity management. In addition, several entities attained *Repeatable but Intuitive* rating for information security and change management practices. By contrast, these entities have practices below the minimum baseline and need to provide effective management of their IT resources and risks to order to realise the benefits from their IT investments.

4.136 The overall maturity of practices did not vary significantly between large and smaller entities. However, the achievement of specific information security maturity indicators did vary. Most large entities have well established information security processes and have information security plans for some important business systems. Several smaller entities need to improve their practices by gaining a better understanding of their specific security risks and establishing an information security policy, plan, and investigating security breaches and incidents.

4.137 The outsourcing of IT infrastructure under the cluster contract arrangements has generally had a positive impact on the maturity of information security and change management practices, with well defined processes being established. However, outsourcing did not have a strong influence in improving the entities' business continuity management practices. Entities tended to rely on the outsourcer for their IT disaster recovery planning. However, most contracts reviewed did not specify the entities' specific business risk, business systems, agreed service levels for business continuity management, and disaster recovery plan requirements.

Emerging issues

4.138 The ANAO increased its focus on the adequacy of entities' IT controls structures as part of the ANAO's financial statement audits during 2001–2002. The audit results were published in *Control Structures as a part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2002*[38]. The audit concluded that several entities were experiencing internal control difficulties in managing their IT environments, specifically security and business continuity management.

4.139 By comparison with the audit results published in that Report, several entities, though not necessarily the same entities, continue to experience internal control difficulties in information security management. In addition, many entities have not maintained current business continuity management plans since the passing of the year 2000 threat. In line with the *Commonwealth and State Governments' Domestic Counter Terrorist Arrangements*, entities need to reassess and prioritise their information security and business continuity risks.

4.140 The areas of focus for entities in the coming year are to continue to improve processes which assist in better aligning the IT governance framework with business objectives.

4.141 Opportunities exist for most entities to continue to improve their IT processes covering:

- tightening of information security across the entity and within key business applications;
- actively managing the security requirements specified in their outsourcing contracts;
- gaining a better understanding of their specific business continuity risks and business impact, assigning operational responsibility, establishing quality business continuity plans and disaster recovery plans and performing followup reporting on progress; and

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[38] ANAO Report No.67 of 2001–2002, *Controls Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2002,* ANAO, Canberra.

- maintaining the responsibility for business continuity planning and establishing more clearly defined relationships with their outsourcers to ensure they are both aware of the business continuity risks.

4.142 The amount of effort necessary in these areas is dependant upon an assessment of the risk versus return equation on the level of IT investment required as well as the extent to which an entity is dependent on IT to achieve its corporate goals.

4.143 As there is a fundamental dependency, or at least a significant interdependency, in the IT area, an important and practical consideration will be the need to balance affordable IT governance against expected costs.

5. Control Procedures

Introduction

5.1 An entity's system of internal control includes the procedures established to provide reasonable assurance that operational and administrative objectives and goals are achieved. Internal control procedures within significant operational and accounting processes and financial systems are assessed as part of the audit of an entity's financial statements. In most entities, key areas covered in the interim phase of the audit will include:

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

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

Results summary

5.3 Overall, the results of the interim audits of entities reviewed in this report indicate that there has been a marginal improvement in the quality of control procedures over business and accounting processes. This is demonstrated by:

- the number of entities with 'A' category audit findings reduced to two in 2002–2003 from four in 2001–2002;
- the total number of 'B' category audit findings across all entities reduced from 116 in 2001–2002 to 96 in 2002–2003;
- eleven of the 21 entities reported an improvement in the number of 'A' and 'B' category audit findings; four entities showing a deterioration of their position, with six entities remaining in the same position; and
- the number of entities with no category 'A' or 'B' audit findings remained at two for both years.

5.4 A summary of the results of interim audit testing for the major entities for the period 1 July 2002 to 31 March 2003, is set out in Chapter 6.

5.5 Commentary on entities' control procedures over key financial categories follows.

Appropriations and other revenues

5.6 Appropriations, both departmental and administered, represent the primary source of revenue for most entities. There are entities which also collect significant revenues in the form of taxation, excise and administered levies. Moderate amounts of other revenues are also generated from the sale of goods and services and from interest earned from cash funds on deposit.

Findings

5.7 The ANAO's testing disclosed that control frameworks in entities relating to the collection, receipt and management of appropriations, levies and other revenues have improved marginally over the past year. Common weaknesses noted in the current year relate to controls over the timely completion and/or review of the reconciliation process for appropriation and other revenue accounts.

5.8 Entities where control issues relating to appropriations, revenues or related issues have been noted include:

- Attorney-General's Department;
- Department of Agriculture, Fisheries and Forestry—Australia;
- Australian Taxation Office;
- Department of Defence;
- Department of Employment and Workplace Relations;
- Department of the Environment and Heritage; and
- Department of the Treasury.

5.9 Details of the particular issues for each entity are outlined in Chapter 6. In all cases, entities concerned have agreed to improve their processes over the remaining months of the financial year.

Payment of expenses

5.10 Departmental appropriations are largely disbursed to meet employment costs and supplies relating to rental of premises, leasing of IT equipment, administrative costs, contractors' and consultants' costs and other services. Most entities also disburse administered funds on behalf of the Government on items such as grants, subsidies, benefits, levies and other similar forms of financial assistance.

5.11 Reconciliation processes, segregation of duties, appropriate delegations and access controls, combined with other measures, provide an effective means of ensuring that payments are valid and accurately recorded, and that funds are not mismanaged or subject to fraud.

Findings

5.12 In most entities, payment processes are well established. The ANAO's interim testing has disclosed that payment control frameworks are generally effective, with most entities continuing to improve controls over the past year. Individual entities continue to have weaknesses over payment processes which are specific to their operations covering issues such as:

- special account reconciliation processes;
- appropriate segregation of duties;
- appropriate delegations;
- correct classification of expenses in the general ledger;
- monitoring of obligations under grant and funding agreements;
- reconciliation of payment programs, GST business activity statements, supplier invoices including resolution of disputes;
- authorisation of disbursements; and
- preparation and clearance of outstanding purchase orders.

5.13 A number of these matters were noted as control issues in last year's corresponding report.

5.14 Entities, where control issues relating to control over payments or related issues have been noted, include:

- Department of Agriculture, Fisheries and Forestry—Australia;
- Australian Taxation Office;
- Department of Communications, Information Technology and the Arts;
- Department of Defence;
- Department of Employment and Workplace Relations;
- Department of the Environment and Heritage;
- Department of Health and Ageing;
- Department of Industry, Tourism and Resources;
- Department of Transport and Regional Services; and
- Department of the Treasury.

5.15 Details of the particular issues for each entity are outlined in Chapter 6. Entities have agreed to address these issues prior to year end or as soon as possible thereafter.

Employment and related costs

5.16 Employment and related entitlements normally represent the largest departmental expenditure item or running cost. In many instances, personnel costs represent one of the larger liabilities entities will need to meet, in particular, the accumulated recreation and long service leave provision balances.

5.17 Given the significance of salaries as an expense item, those entities that do not have an integrated FMIS and HRMIS, require a reconciliation process which ensures fortnightly payroll amounts are accurately recorded. Without this reconciliation process, monthly financial reporting can be inaccurate and could be potentially misleading to management and other internal users of financial reports. Payroll reconciliations need to be performed regularly, preferably fortnightly but at least monthly, to clear up any differences prior to the preparation of the monthly or annual financial reports.

Findings

5.18 FMISs and HRMISs, including those contracted to external providers, have been reasonably stable in most entities, with control frameworks assessed as generally effective. However, as was also noted in last year's corresponding report, a number of entities continue to have difficulty in reconciling costs incurred in their salary and personnel systems with the balances recorded in their FMISs.

5.19 Entities where control issues relating to employment costs or related issues have been noted include:

- Australian Taxation Office;
- Department of Agriculture, Fisheries and Forestry—Australia;
- Department of Communications, Information Technology and the Arts (core and ScreenSound);
- Department of Defence;
- Department of Employment and Workplace Relations;
- Department of Family and Community Services; and
- Department of the Treasury.

5.20 Details of the particular issues for each entity are outlined in Chapter 6.

Cash management

5.21 Departmental appropriations are deposited into entities' bank accounts each fortnight with an attaching responsibility for entities to manage their cash flows to ensure they have the necessary liquidity to meet their commitments as they fall due. Surplus funds are usually placed on overnight deposit with the Reserve Bank of Australia (RBA) as part of cash management and banking arrangements. They can also be placed on deposit for selected periods of time with approved financial institutions. In this environment, it is essential that funds transferred to the RBA and other bodies are approved and that bank reconciliation and management processes track the movement of funds to, and from, all bank accounts.

5.22 Following a reconsideration of the management of cash at a 'Whole of Government' level, the Department of Finance is moving to implement a 'just in time' appropriation drawdown regime for major departments in 2003–2004. This will require affected entities to adjust their control frameworks to accommodate this initiative.

Findings

5.23 Cash management processes are integrally linked to the management of appropriations and receipts and also to the payment of employment and suppliers costs.

5.24 Control weaknesses identified this year generally related to:

- timely completion and review of bank reconciliations;
- proper authority levels approving the investment of surplus funds; and
- ensuring appropriate access to online banking systems.

5.25 Entities where control issues relating to cash management or related issues have been noted include:

- Australian Customs Service;
- Australian Taxation Office;
- Department of Agriculture, Fisheries and Forestry—Australia;
- Department of Defence; and
- Department of the Treasury.

5.26 Details of the particular issues for each entity are outlined in Chapter 6.

Asset and contract management

5.27 Asset and contract management, particularly in relation to the maintenance of reliable asset and contract registers, has been an issue of concern raised consistently by the ANAO and the Joint Committee of Public Accounts and Audit (JCPAA) in previous years, particularly in relation to:

- poor documentation relating to asset acquisitions and disposals and such transactions not being recorded in a timely manner;
- assets on hand not being recorded on the asset register;
- asset registers not being regularly reconciled to financial systems; and
- appropriate application of capitalisation policies for internally developed software.

Findings

5.28 These issues continue to be experienced in various entities.

5.29 Entities, where control issues relating to asset management or related issues have been noted, include:

- Department of Agriculture, Fisheries and Forestry—Australia;
- Department of Communications, Information Technology and the Arts;
- Department of Defence;
- Department of Family and Community Services;
- Department of the Treasury;
- Department of Veterans' Affairs; and
- Health Insurance Commission.

5.30 A recent Business Support Process (BSP) audit on Software Capitalisation, the report on which is scheduled to be tabled by 30 June 2003, confirmed that the identification and processing of only those costs appropriately related to in-house software development is an issue for some entities.

Details of the particular issues for each entity are outlined in Chapter 6.

Conclusion

5.31 The ANAO continues to highlight the need for continuing improvements in reconciliation processes relating to bank accounts, payroll processing, appropriations, other revenues, interface systems and asset registers. Reconciliations are integral to ensuring the information in financial systems is complete, accurate and valid.

5.32 In last year's corresponding report, the ANAO noted that most entities improved the consistent application of reconciliation procedures, with only a small number of entities continuing to experience inconsistency. For the 2002–2003 year, a continuing problem in many entities is the need to reconcile payroll and leave costs recorded in the HRMIS to the balances recorded in the FMIS. The ANAO continues to reinforce the importance of this reconciliation process, given the significance of personnel costs to entities and the potential impact for errors in financial reporting.

5.33 The ANAO also notes the increasing incidence of entities undertaking significant in-house software developments and the consequent issues surrounding the proper distinction between the capitalised and operating expenditures.

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

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

Introduction

6.1 This part of the report summarises the results of examinations of internal control structures of major individual Commonwealth entities as part of the interim audits of their financial statements for the year ending 30 June 2003. These entities primarily comprise the portfolio departments that manage the majority of the Commonwealth's financial activities and operate the more significant and complex financial systems.

6.2 The ANAO's audits of Commonwealth authorities, companies and subsidiaries are performed on a continuous basis. They are structured to meet Board commitments as well as the Commonwealth reporting deadline of 15 August 2003. The results of the audits of these bodies will also be included in the Auditor-General's *Report on the Audits of Financial Statements of Commonwealth Entities* expected to be tabled in December 2003.

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

- introductory commentary regarding its business operations;
- key business and financial statement risks;
- comments on selective corporate governance arrangements;
- audit results, including reference to the more significant issues identified covering general audit procedures, IT processes, IT security and business resumption planning;
- a summary of financial reporting capability; and
- a conclusion.

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

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

A: those matters that pose significant business or financial risk to the entity and must be addressed as a matter of urgency;

B: control weaknesses which pose moderate business or financial risk to the entity or matters referred to management in the past which have not been addressed satisfactorily; and

C: matters that are procedural in nature or minor administrative shortcomings.

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

6.7 This part of the report discusses the more significant matters identified ('A' and 'B' category issues) in separate sections for each entity. Individual tables for each entity track progress on matters raised from our audits of the 30 June 2003 financial statements.

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

6.9 Table 2 of Appendix 1 summarises the more significant matters included for each entity.

Department of Agriculture, Fisheries and Forestry—Australia

Business operations

6.10 The Department of Agriculture, Fisheries and Forestry—Australia's (AFFA's) mission is:

> Increasing the profitability, competitiveness and sustainability of Australian agricultural, food, fisheries and forestry industries and enhancing the natural resource base to achieve greater national wealth and stronger rural and regional communities.

6.11 AFFA is primarily responsible for the delivery of policy advice and program administration in the areas of:

- natural resources access and management;
- rural policy and innovation;
- industry development;
- market access and biosecurity;
- product integrity, animal (including aquatic animal) and plant health;
- quarantine and export services;
- scientific advice; and
- economic research.

6.12 Budgeted departmental revenues for 2002–2003 are $467.4 million[39], comprising mainly of outputs appropriation revenue of $275.1 million and sales of goods and services of $179.6 million. The Department's estimated average staffing level for 2002–2003 is 3363. Australian Quarantine Inspection Service (AQIS) and the National Residue Survey (NRS) are both separate reporting entities which are consolidated into AFFA's departmental statements.

6.13 Budgeted administered revenues (non appropriation) for 2002–2003 amount to $540.1 million and mainly relate to levy collections. Budgeted administered expenses in 2002–2003 of $1325.6 million comprise mostly of levy payments, grants and personal benefits.

Key business and financial statement risks

6.14 The Department's key business risks relate to its responsibilities for:

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[39] Estimates are as at Additional Estimates 2002–2003.

- detection and prevention of unwanted diseases and pests from entering Australia;
- management of industry support and adjustment programs including drought relief;
- management of natural resource sustainability; and
- management of contracted service arrangements.

6.15 ANAO assessment of the risk of material misstatement in the Department's 2002–2003 financial statements is medium. Key financial risks identified are:

- administered levies, including misstatement of levies expense, payables, revenues and receivables and legislative compliance for collections and disbursements;
- administered grants and personal benefits payments, including incorrect recognition of accruals;
- departmental/administered classification of suppliers payments; and
- departmental employee expenses and liabilities.

Corporate governance

6.16 The Department has a strong corporate governance framework, which includes:

- monthly executive management meetings;
- an audit committee which meets eight times a year and focuses on ANAO activities, the internal audit program, risk management and fraud control;
- a finance subcommittee which meets eight times a year and oversights production of the annual financial statements;
- plans, policies and procedures which are generally comprehensive and up to date, including a corporate plan, business plans for the Department and each Division, a fraud control plan, an overarching risk management framework that assesses and treats risks at the corporate, business and project level, a range of Chief Executive Instructions, and a well-based delegations management system;
- monthly financial reports reviewed by the executive; and
- a Corporate Governance Unit, independent of line areas, that reports directly to the Secretary on governance-related matters.

Audit results

6.17 The following table provides a summary of prior year and current year audit issues raised by the ANAO. New issues identified to March 2003 are outlined below.

Category	Issues outstanding as at March 2002	Issues resolved by March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	1	1	4	4
Total	**1**	**1**	**4**	**4**

Departmental outputs appropriation

6.18 AFFA had omitted legislative amendments required for Departmental special appropriation funding of $30.484 million in 2002–2003. The funding related to a 2001–2002 Additional Estimates measure for 40 per cent Government subsidisation of AQIS export certification costs. AFFA's Departmental special appropriation funding drawn down from the Department of Finance's Cash and Appropriation Management Module (CAMMS) of AIMS consequently did not have any underlying appropriation authority. This may have resulted in a breach of the Constitution had it been identified after financial year end.

Personal benefits

6.19 AFFA engages Centrelink, and to a lesser extent State and Territory Governments, to deliver personal benefits programmes on its behalf. Centrelink advises AFFA daily of funding amounts required and provides monthly reports to AFFA detailing program expenditures. However, Centrelink does not perform checks nor reports on payment accuracy. Consequently, AFFA lacks assurance that benefit payments are being accurately processed on its behalf.

6.20 Centrelink also currently does not inform AFFA of benefit overpayments recoverable or recovered, but rather nets off refunds received against the following day's funding requirement. AFFA consequently may omit material amounts of benefits recovered or recoverable from its financial statements, or may incorrectly credit recoveries of prior year personal benefit payments to the current year appropriation.

Classification of suppliers expenditures

6.21 The Department has classified supplier payments which are departmental in nature as administered transactions. Administered payments of several million dollars have been made to various Commonwealth agencies and other administered payments have been made to consultants, contractors and to State

Governments for fee for service transactions. These misclassifications are inconsistent with the Finance Minister's Orders and accounting standards; understate the cost of AFFA's outputs; and diminish funding and reporting transparency overall.

Business continuity planning

6.22 Business continuity planning seeks to ensure the uninterrupted availability of all key business resources required to support critical business activities and is an integral element of an agency's risk management strategy. The ANAO understands that AFFA has undertaken a number of activities to address business continuity planning, including the development of application specific business continuity plans (BCP). However, whilst AFFA has a BCP for QSP, it has not been tested to ensure that it adequately meets business objectives and that potential risks affecting critical business processes can be mitigated.

Conclusion

6.23 ANAO considers that, in general, the Department maintains a strong internal control structure which provides assurance over the preparation of the financial statements. The Department continues to actively identify and address control deficiencies and progress financial reporting issues and has responded positively to ANAO recommendations. In particular, the Department has made substantial improvements in the management of levies collection and disbursements through the new Phoenix system.

Attorney-General's Department

Business operations

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

6.25 The total appropriation for the Department, including additional estimates and special appropriations for 2002–2003, is $456.5 million. In summary, the appropriations for the year ended 30 June 2003 for the department comprise:

- price of outputs—$135.0 million;
- administered appropriations—$289.8 million; and
- special appropriations—$31.7 million.

6.26 Departmental equity injections:—$15.0 million for the Administrative Review Tribunal was appropriated in a prior year and has been carried over to 2002-2003. This amount will be returned to the OPA in 2002–2003.

6.27 The Department's average staffing level is 651.

Key business and financial statement risks

6.28 In order to manage its business risks, the Department addresses key issues relating to the timely and efficient delivery of effective legislative policy and advice and other services (e.g. administration of legislation, coordinating national security, implementing Commonwealth policy on family law, management of Emergency Management Australia, administering of Royal Commissions and legal aid) and its reputation and relationship with its business partners, which are generally subject to detailed external scrutiny.

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

6.30 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is medium. The key issues for the current year include:

- restructuring of the corporate services;
- implementation of SAP upgrade (to 4.6); and
- prior year audit findings.

Corporate governance

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

- a corporate plan (updated 2001) which outlines broad strategic directions and is supported by operational plans which detail activities and associated resourcing and performance information;
- the executive which conducts weekly meetings with division heads and evaluates key issues;
- the executive meets fortnightly to review divisional performance against operational plans and their plans for the next 6–12 months. Each division gets reviewed twice a year;
- an audit committee that meets quarterly and actively focuses on internal controls, management of financial risks, review of financial reporting, control of finances, assets and regulatory compliance;
- a monthly reporting regime which reports actual versus budgeted departmental and administered activity across outputs and outcomes and provides an analytical review of performance;
- an internal audit strategy and plan, which addresses key departmental business and financial risks and covers relevant programs; and
- risk management plans which identify the strategic risks at divisional level to make divisional managers aware of the risks they are required to manage.

6.32 The financial statement audit focuses on the material financial reporting risks flowing from the significant business risks and key business and accounting processes including those mentioned above.

Audit results

6.33 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised by the ANAO during the interim phase of the audit.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	4	4	1	1
Total	**4**	**4**	**1**	**1**

6.34 Specific audit results requiring comment are as follows.

Administered appropriations and special accounts reconciliation

6.35 The Department's administered appropriations and special accounts reconciliation process was found to be overly complex and subject to human error. The reconciliations were not reviewed by an independent officer and contained outstanding items, which had not been cleared in a timely manner.

6.36 The Department has advised of appropriate action taken, or proposed, to address and/or minimise the exposure from these issues.

Financial reporting processes

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

Conclusion

6.38 A number of departmental initiatives are evident and have addressed prior year audit findings. The Department has advised of appropriate remedial action with a control weakness identified in this year's audit.

Australian Customs Service

Business operations

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

6.40 Given the heightened awareness on national security, Customs has contributed to Australia's counter-terrorism capabilities while continuing cooperative border protection measures and enhancing maritime surveillance and response capabilities. Customs has on going responsibility for the assessment and, where appropriate, the collection of Goods and Services Tax (GST) on imported goods, Wine Equalisation Tax (WET) and Luxury Car Tax (LCT). Customs also administers the Tourist Refund Scheme and the compliance activity, in conjunction with the Australian Taxation Office, in relation to the GST, WET and LCT for both imported and exported goods. Customs is also in the process of modernising its cargo-management practices and have undergone an organisational restructure to better align the core functions with the changing business processes.

6.41 Total appropriation for Customs in 2002–2003 for its price of outputs is $772.6 million. In addition, Customs received an equity injection of $12.1 million for its marine vessel finance lease and purchase of container x-ray and pallet x-ray machines for Australia's response to border protection.

6.42 Customs' average staffing level for 2002–2003 is 4707.

Key business and financial statement risks

6.43 In order to manage its business risks, Customs addresses key issues associated with:

- safeguarding Australian borders including contributing to counter-terrorism capabilities;
- the assessment and collection of Commonwealth revenue;
- the protection of the community against illegal importation and the dumping of goods into Australia;
- the fight against illicit drugs and other quarantine risks; and
- the operation of detection programs to identify non-compliance with legislative requirements for revenue leakages and border control including terrorism.

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

6.45 Key business issues for current year include the:

- phased implementation of the cargo management re-engineering system that will replace the existing sea and air cargo automation systems and its impact on revenue;
- development of a Compliance Assurance Strategy that aims to ensure self-regulated compliance with government requirements in the international trading environment with the change in business processes;
- implementation of measures for Australia's response to the foot and mouth disease and other quarantine risks and terrorism for which additional resources have been allocated;
- collection and reporting of customs revenues, including difficulties associated with import duties, self assessment, and complicated legislation; and
- control over the changing nature of complex IT systems, processes and databases, including electronic commerce related activities.

6.46 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is at the medium level. Key issues for the current year include:

- adequacy of compliance programs and their impact on revenue;
- asset management;
- debt management;
- accounting for employee entitlements; and
- the financial statement close process and the adequacy of documentation of the audit trail.

6.47 The financial statement audit focussed on the material financial reporting issues flowing from the significant business risks, key business and accounting processes, including the above issues.

Corporate governance

6.48 Customs continues to have in place measures that contribute to sound corporate governance and to financial statement assurance. These arrangements include:

- an audit committee that meets at least quarterly and which focus on internal and risk management issues;
- an internal audit strategy and plan that addresses key business and financial risks and aim to assist line areas meet their key objectives and contribute to Customs outcome and outputs;
- a structured framework for incorporating risk management into the broader management and business processes including the development of a fraud control plan that is in line with the Commonwealth Fraud Control Guidelines;
- a Compliance Assurance Strategy that aim to better align Customs' changing priorities and business practices and provide assurance on the integrity of revenue management activities;
- a number of financial management improvement projects to facilitate the financial statement preparation and audit process and to restructure the chart of accounts to align with the new organisation structure and business practices; and
- a monthly reporting regime to the Executive that provide key financial information and performance measures.

6.49 These measures also contributed to the reliability of the systems of internal control and compliance with accounting and financial policies.

6.50 Customs has a strong culture to perform its mandatory role as a regulatory agency and has adopted risk management techniques to ensure compliance of its regulations by clients. Customs is also aware of the changing risks associated with its business re-engineering process and has considered the various strategies and treatment types to mitigate the risk.

Audit results

6.51 The following table provides a summary of the status of prior year as well as 2002–2003 audit issues raised to date by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	2	1	1	2
Total	**2**	**1**	**1**	**2**

6.52 The results of the interim audit work reflect further improvements in Customs' control environment since last year. These improvements include a pro-active approach to implementing necessary policies and procedures, and strengthening current controls. In addition, Customs has implemented a number of programs to meet changing business requirements and to enhance the financial and business management reporting framework.

6.53 However, the audit noted again a need to manage better the debt recovery process associated with post warrant amendments (PWAs). The ANAO also noted that there is scope for improvement in some aspects of IT security policies and arrangements.

Debt management

6.54 A follow-up review of debt management on PWAs found instances of lack of or delays in debt recovery action and non-compliance with Customs' Chief Executive Instructions on debt recovery procedures.

IT security

6.55 A review of application security implemented for Customs' FMIS, QSP and human resources management system, PeopleSoft found that there were no formalised security policies or procedures existed for either application. In addition weaknesses were noted in some of the security practices relating to granting and revocation of access to QSP.

6.56 Customs has advised of remedial action taken or proposed.

Financial reporting

6.57 Customs has a sound financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management by key business areas and by regions. Monthly reports are produced promptly and seek to explain variances from budget or expected outcomes and detail any areas that are of interest to the executive.

Conclusion

6.58 Customs has improved its internal control structure by taking remedial action on audit issues raised in the previous year relating to its quality assurance programs over audits conducted under the then National Compliance Improvement Plan and asset management.

Department of Communications, Information Technology and the Arts

Business operations

6.59 The Department of Communications, Information Technology and the Arts (the Department) provides strategic advice and professional support to the Government on a wide range of policy areas including the arts, cultural development, broadcasting and online regulation, information and communications technology, intellectual property, sport and telecommunications.

6.60 The Department also administers legislation, regulations, grants and incentives to industry and the wider community, and supports advisory councils and committees.

6.61 The Department also includes Artbank, the National Science and Technology Centre (Questacon) and ScreenSound Australia (ScreenSound).

6.62 The Department's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$176.639 million; and
- administered appropriations—$284.088 million.

6.63 The Departments average staffing level is 913.

Business and financial statement risks

6.64 In order to manage its business risks, the department addresses the following key risks:

- policy advice—the inability of the Department to deliver the government's or minister's agenda when providing policy advice;
- program delivery—the non-delivery the government's or minister's agenda when delivering programs;
- corporate governance—the non-establishment of corporate governance arrangements, including an effective accountability framework, to provide the executive and minister with assurances that effective business management is occurring;
- contract management—the mismanagement of its contractual arrangements with its key service providers in a way that allows the effective and efficient delivery of services; and

- resource management—the inability to deliver agreed outputs and outcomes because of an inability to recruit, maintain and develop an appropriate skill base.

6.65 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is medium. Key issues for the current year include:

- IT control environment;
- management and reporting of special accounts;
- asset management and reporting;
- reduced reporting timetable; and
- financial statement preparation.

6.66 The financial statement audit will focus on the material financial reporting risks flowing from the significant business risks and key business and accounting processes, including the above specific issues.

Corporate governance

6.67 Generally, a strong corporate governance regime imposes an alignment in the authority, responsibility and accountability within an entity. The principles of effective governance should be reflected in an entity's structure and processes, external reputation, internal controls and standards of behaviour.

6.68 Over the past year, the Department has strengthened its control structure to respond better to business and financial risks. The Department has developed a risk management plan and action plans (including an update of the fraud control plan) to address the risks identified. To support these plans the Department has:

- the Executive Management Group (EMG) which meets regularly to advise the Secretary on operational issues and monitor the financial performance of the Departmental and its Administered programs;
- financial reports which are submitted to the Secretary and EMG which have been expanded upon from the previous financial year. These revised reports have significantly improved the ability to analyse financial performance;
- an Audit, Risk and Evaluation Committee which meets at least quarterly, focusing on risk management and the control environment, particularly relating to financial systems, accounting processes, audit planning and reporting. An external member has recently been appointed to the committee. The Committee regularly reviews performance and monitors achievements against audit plans; and

- an internal audit strategy and plan which, within available resources, addresses key financial and business risks based on management priorities. The annual plan is presented to the audit committee for approval and performance is reviewed quarterly against the approved plan.

6.69 Artbank, Questacon and ScreenSound provide monthly reports and financial data to the core department for incorporation into the Department's monthly reports. This data is reviewed and approved by both Questacon's and ScreenSound's executive management before the information is provided to the Department.

6.70 The operation and effectiveness of these measures are subject to ongoing review.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	Status of prior issues at March 2003	Prior issues still to be tested	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0	0	0
B	8	4	4	0	3	7
Total	**8**	**4**	**4**	**0**	**3**	**7**

Audit results

General audit findings

Reconciliation regime

6.71 Reconciliations are a fundamental control procedure used to ensure that only valid information is posted from various sources to the general ledger, which forms the basis of the production of the financial statements. Common reconciliations undertaken by management include bank reconciliations; asset register to general ledger; payroll system to general ledger, other subsidiary ledger including the accounts payable and accounts receivable ledgers to general ledger and, where applicable, a reconciliation of appropriation transactions and expenses for each special account.

6.72 The Department has in place a reconciliation regime encompassing the above. However, deficiencies were identified in the performance of reconciliations in terms of:

- review of bank and payroll reconciliations at ScreenSound;
- review of asset register and general ledger reconciliation at ScreenSound; and

- reconciling items being identified relating to bank reconciliations but not being followed up.

6.73 In addition, the ANAO has recommended the Department develops a reconciliation process to monitor leave liabilities.

6.74 The failure to undertake effectively reconciliations can lead to errors not being identified and corrected in a timely manner.

Management of purchases

6.75 The use of purchase orders is a key control in purchase management. It was found that not all areas of the Department, notably Questacon, did not always utilise purchase orders to perform this control function or that the management of the purchase orders could be improved. In other areas, principally ScreenSound, the existing process for the generation of purchase orders resulted in a significant duplication of effort between the line areas and Finance section. The ANAO has recommended that a Departmental wide policy and process be developed to provide a consistent approach to purchase management.

Management of outsourced functions

6.76 The Department outsources a number of functions including the provision of Human Resource Management and Information Technology Support. The ANAO has recommended that the Department establish a more formal process to ensure that suitable control structures exist over these functions.

IT business processes

Security

6.77 Processes used to safeguard information are key to ensuring that information is protected from unauthorised use, disclosure, modification, damage or loss. The ANAO identified a weakness in documenting access profiles for the Department, which are used to allocate staff access to the financial system. The ANAO has recommended that the Department improve its processes to ensure that access profiles are documented and changes to these profiles are reviewed to ensure that staff members are granted access on a 'least access required' basis.

Change management

6.78 The processes used to control the movement and authorisation of changes to systems are a key element in ensuring only appropriately authorised and tested changes are implemented into a production environment. The ANAO identified that, while the Department had sound change management processes governing IT infrastructure, Questacon did not have a formalised change control process governing change requests to Finance One. The ANAO has recommended that Questacon develop formal change management processes.

Business continuity management

6.79 The objective of a business continuity management process is to ensure the uninterrupted availability of all key business resources required to support critical business activities. As this is viewed as a key element of an entity’s risk management strategy, the ANAO has reviewed elements of the process that were in place to support this.

6.80 The ANAO found a number of weaknesses in the business continuity management process. The Department has not recently undertaken an assessment of the risks that may impact upon key business processes from an organisational wide viewpoint. Each entity did not have a business continuity plan, which addresses the continuity of their key business processes extending beyond the information systems and infrastructure. While ScreenSound had established a current disaster recovery plan, which addresses the availability and recoverability of its IT infrastructure, the Department’s disaster recovery plan for its IT infrastructure is dated and does not include specific business processes critical to the Department’s business operations. Although Questacon has not yet established its disaster recovery plan, it has commenced its risk assessment phase. The ANAO has recommended that the Department as a priority improve its business continuity management processes.

Financial reporting

6.81 Over the past year, improvements have been achieved in the quality and presentation of financial data and reporting available to the Secretary, executive and business areas. Improvements in the quality of financial reporting are expected to continue in the year ahead as the Department has been able to strengthen the resources in the Corporate Finance area as well as tightening its end of month processes for its business and accrual accounting processes. These factors should also alleviate some of the problems associated with the preparation of the financial statements which had been experienced in the previous financial year. However, the ANAO has recommended the Department, primarily Questacon, adopt more stringent month end procedures to ensure that all material components are incorporated to support management decision-making through the year.

Conclusion

6.82 Progress has been achieved in strengthening the control environment. However, further improvements are necessary, particularly in relation to end of month financial reporting procedures, management of outsource contracts and asset management. The Department has accepted ANAO findings and has agreed to implement remedial action.

Department of Defence

Business operations

6.83 The Department of Defence (Defence) is responsible for the defence of Australia and its national interest. Defence's business is focused on the delivery of the following outputs:

- Defence Operations;
- Navy Capabilities;
- Army Capabilities;
- Air Force Capabilities;
- Strategic Policy; and
- Intelligence.

6.84 Defence's principal appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$18 338 million; and
- administered appropriations—$2 236 million.

6.85 Defence's average staffing level for 2002–2003 is estimated at 90 371, comprising permanent forces of 52 069, total reserves of 20 358 and total civilian staff of 17 944.

Key business and financial statement risks

6.86 ANAO has identified Defence's key business risks to include:

- corporate regime—adequate processes and controls to provide appropriate assurance over the information produced for operational and reporting purposes;
- group structure—ability to allocate resources effectively due to a structure that inhibits planning processes, most importantly asset procurement;
- change management—the potential threat of not maximising resources made available for core activities in an environment of significant organisational change;
- contract/project management—ability to deliver or enhance current service levels while ensuring they are delivered cost effectively;
- human resources—difficulties in recruiting and retaining adequately skilled staff to achieve business objectives; and

- data ownership—sufficient ownership of data leading to major integrity issues.

6.87 The ANAO assessment of the risk of material misstatement in the 2002–2003 Defence financial statements is **high**. Major factors include:

- prior year qualifications;
- Defence's internal financial reporting arrangements;
- system and data integrity, including key systems used to record inventory and repairable items, personnel payments and balances and supplier related transactions; and
- asset management, including asset recognition and write downs, assets under construction and inventory valuation and consumption.

6.88 The financial statement audit will focus on the material financial reporting issues flowing from the significant business risks, business and accounting processes and the above issues.

Corporate governance

6.89 As part of the audit planning process, the ANAO has undertaken a high level review of the Corporate Governance framework and resultant procedures in place within Defence. The results of the review impact the necessary audit procedures to be completed by the ANAO in order to provide Defence with an audit opinion. While the ANAO has noted that Defence continues to address a wide range of data integrity issues, a number of which will take several years to resolve, the ANAO considers that the data quality, system control and process ownership issues which remain in evidence detract from the effectiveness of the procedures in place.

6.90 These issues will be responded to by Defence as part of their reply to the 2002–2003 interim audit.

Audit results

6.91 The following table provides a summary of the status of prior year as well as 2002–2003 audit issues raised to date by the ANAO during the interim phase of the audit.

Category	Issues outstanding as at March 2002	Issues resolved prior to August 2002	New issues to August 2002	Issues resolved prior to March 2003	Issue reclassified or merged *	New issues to March 2003	Closing position as at March 2003
A	13	10	5	1	1	4	10
B	32	23	18	5	7	14	29
Total	**45**	**33**	**23**	**6**	**8**	**18**	**39**

* Issues in this column represent the net number of issues that have either been reclassified, or merged into another issue.

6.92 Six of the above Category 'A' findings remain outstanding from reports issued in prior years. Defence advise progress continues to be made against these findings. In summary, these findings relate to:

- integrity of data recorded on the Standard Defence Supply System (SDSS) and COMSARM, the major inventory management systems of Defence; and
- security administration within PMKeyS, the major personnel system of Defence.

SDSS/COMSARM

6.93 Defence is currently assessing the timing of the SDSS upgrade. However, significant long-term control issues within the current version and also the business process supporting COMSARM have required extensive and costly 'workarounds' to be implemented by Defence. The current position of a number of 'workarounds' remains unclear, as sufficient work has not yet been undertaken. Defence advises it is currently assessing the results of this work and the implications for the 2002-2003 financial statements. The ANAO acknowledges the difficulty in attempting to implement procedures to provide adequate assurance over the balances and transactions within SDSS on an ongoing basis. However, formal resolution to the problems of 2001–2002 has not yet been achieved in a number of cases. A number of these issues are likely to be addressed when an upgrade of the SDSS system is implemented in 2003–2004 financial year.

Defence's general ledger system: ROMAN

6.94 The ANAO has undertaken a review of the ROMAN (SAP R/3) system, with the objective of assessing the status of controls that impact on the reliability of the information provided by Defence. The results of the review include:

- weaknesses in the 'purchase to pay' control framework, which will require additional work prior to the ANAO being able to rely on the validity of data residing within the system; and
- significant issues within the 'security administration' and the 'change control' procedures and controls, which have the ability to directly impact the integrity of data and effect the ANAO's planned audit reliance.

6.95 A number of other issues were also noted that continue to impact on the integrity of the data within ROMAN. These include data ownership and unreliable data from logistical and personnel systems, which must be dealt with to provide management with the assurance over the financial information and the ability to effectively direct resource allocation. As ROMAN is the General Ledger of Defence, all data integrity issues from logistical and personnel systems as well as internally derived issues will be included in the information used by management to carry out their duties.

Defence's personnel systems: PMKeyS and ADFPAY

6.96 The ANAO's evaluation of the internal controls surrounding payments and balances within the PMKeyS and ADFPAY systems is that they are not yet sufficient to ensure the accuracy of all payments and balances within the system. In 2001–2002 Defence had focused additional resources into completing sufficient work to assure management and the ANAO of the reliability of the systems, however, for the 2002–2003 financial statements, despite progress being made, issues remain outstanding. Additional resources were also focused at further implementing and maintaining the control framework surrounding the systems, however to date completion of a number of requirements are also outstanding.

6.97 While additional ongoing funding has recently been negotiated, Defence had not previously budgeted for the funding of PMKeyS 'as an ongoing enterprise system'. This is of considerable concern, where inadequacies of executive planning and management have resulted in major additional expense to provide sufficient assurance over PMKeyS, including the development of separate systems to provide functionality not provided by the current version.

6.98 Further, the ANAO has noted a distinct lack of ownership over the data within PMKeyS, where serious control weaknesses continue to exist and continued disagreement by management over data maintenance responsibilities. Current alignment of responsibilities must be reviewed and issues resolved to ensure the future success of this system, or, any other personnel system that Defence utilises.

Financial reporting

6.99 The integrity of monthly financial reporting continues to be an important issue at Defence. While the monthly reports to the Defence Committee are well designed and include insightful commentary on financial data, of concern is the absence of data integrity, particularly relating to logistical and personnel information, within these reports. This is a result of the number and scale of financial reporting issues, a number of which will take several years to resolve, that compromise the integrity of the report.

Conclusion

6.100 At the time of this report, Defence continues to pursue a wide range of initiatives to address the issues arising out of the ANAO audit.

Repatriation Commission and the Department of Veterans' Affairs

Business operations

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

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

6.103 The Department's appropriation funding for the year ended 30 June 2003 comprises:

- price of outputs—$255.6 million; and
- administered appropriations—$9248.9 million.

6.104 The Department maintains an average staffing level of 2426 across Australia.

Key business and financial statement risks

6.105 Key business risks include:

- the effective management of service level arrangements for the payments of benefits with the Health Insurance Commission and the Department of Health and Ageing and Centrelink;
- decentralised and devolved operations to State Offices, which are managed through quality assurance and monitoring processes;
- continuous changes in veterans' legislation covering the applicability of benefits and levels of benefits to be paid;
- the reliance on external parties to provide information to support entitlements for various government benefit programs;
- maintenance of a sound public profile;
- increased financial management responsibilities and accountability; and
- particular risks related to the Defence Service Homes Insurance Scheme.

6.106 In managing these risks, the Department has put strong emphasis on maintaining adequate business systems and quality assurance procedures for effective administration of payments.

6.107 The ANAO's assessment of the risk of material misstatement in the 2002–2003 financial statements is moderate. Key issues for the current year include:

- payments to veterans together with a verification of year end accrual calculations;
- management and controls surrounding commercial banking arrangements; and
- key areas of Defence Service Homes Insurance Scheme.

The financial statement audit focused on the material financial reporting risks flowing from the significant business risks and selected key business and accounting processes.

Corporate governance

6.108 As part of the financial statement audit, the ANAO observed that the Department has particular strategies and actions in place which contribute to the management of the above risks. The arrangements include the following:

- National Audit and Fraud Committee, which oversees and provides direction to risk management activities and assesses outcomes of external reviews of programs including follow-up actions. The Committee also has a monitoring role in relation to the progress of internal audit and ANAO findings and the accounting and financial statements completion process;
- an Executive Management Group which meets quarterly to determine and evaluate progress on the agreed strategic directions of the Department. The Group is supported by sub-committees that assess the overall performance of the Department's operations through a variety of reporting mechanisms;
- an audit team which develops an internal audit strategy and undertakes risk profiling across the Department. The Department's attitude to the internal audit activities is positive which is reflected through their acceptance of a significant portion of the recommendations suggested by the internal audit; and
- the Department has had a strategic risk management policy since 1995 (last update May 2002) which is reviewed every two years. The policy is

directly linked to the Department's fraud control activities. A detailed risk assessment is prepared from the strategic risk management policy for each program.

Audit results

6.109 The following table provides a summary of the status of prior year issues as well as 2002–2003 financial statement audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	0	0	4	4
Total	**0**	**0**	**4**	**4**

6.110 ANAO's review was directed at key IT systems and financial and accounting processes supporting material financial statement disclosures. In view of the tightening of financial reporting timeframes in future years, and the need for monthly high quality internal reports, there was also audit focus on processes that support the monthly DVA reports to management and to the Department of Finance. This work, together with a comprehensive IT access security process review highlighted a number of risk areas that should be improved to further strengthen the control environment. There were no findings of major significance requiring urgent attention.

General audit findings

Acquisition and reconciliation of Fixed Assets

6.111 During the State Offices visits ANAO identified a number of inadequate asset management practices including incorrect classification, inappropriate system access of asset managers to delete particular asset entries and at another location some supporting documentation could not be found. In addition, there have been a number of shortcomings in relation to the timeliness and accuracy of asset reconciliations. DVA advise that this area is under review by the Financial Reporting and Policy area and substantial progress at the policy level has been made.

Reconciliations of the HR accounts

6.112 Reconciliations between the records in the department's personnel system and general ledger system are regularly performed and are a key process of management assurance on the validity and completeness of balances. The ANAO reviewed a number of reconciliations of the HR accounts and found further scope for improvements in the way the Departmental Payroll Settlement account and the Clearing Account are reconciled. In addition, in order to meet the payroll liabilities, the department uses the Settlement Account for payment of both departmental and administered payrolls. This creates the possibility that administered funds could be applied for the payment of departmental expenditure or vice versa. ANAO recommended strengthening of the controls surrounding the Payroll Settlement Account to ensure this does not happen.

IT Security

Security Plans: follow-up on prior year finding

6.113 IT application security plans provide the organisation with a documented strategy for managing and maintaining access and security to its application programs and data. These plans need to evolve with changes in the operating environment. At the time of the audit, the department was reviewing the plan for a major computer application. However, the plan has not been finalised or endorsed by management. The department subsequently advised the plan is at the risk assessment stage and should be completed shortly.

Business Resumption Planning

Business Recovery Plan

6.114 Business continuity planning is integral to the provision of uninterrupted availability of all business resources/systems required to support key business processes and ultimately continuous service to customers. In reviewing DVA's business continuity planning processes, the ANAO was unable to determine whether a formalised Disaster Prevention Plan, as required in the outsourcing agreement or any formalised disaster recovery plans for the department's IT infrastructure, had been developed and tested. The lack of these plans could result in a breakdown in the process of recovery and/or replacement of IT infrastructure and the subsequent recovering of file management software, application software, system management data and application data.

6.115 The Department is aware of the gap between the current Business Continuity Plan outage requirements and the ability of the outsourcer to re-establish services in the event of a major disaster. DVA management is currently addressing the issue as part of a transition project.

Financial reporting

6.116 The reporting process implemented by the Department is quite comprehensive and includes both financial and non-financial information. The Balanced Scorecard report measures performance against cost, quantity, timeliness, quality and outcome. In addition, monthly reports of actual versus budgeted expenditure are distributed for review by each State and Branch Manager and are discussed at a quarterly meeting of the Corporate Resources Committee.

Conclusion

6.117 The Department's management has acknowledged the audit findings and is actively pursuing resolution of the issues identified.

Department of Education, Science and Training

Business operations

6.118 The Department of Education, Science and Training (the Department) provides advice to the Government and administers programmes to achieve the Commonwealth's objectives for education, science and training. For 2002–2003 the Department's objectives are to ensure that:

- students acquire high quality foundation skills and learning outcomes from schools;
- individuals achieve relevant skills and learning outcomes from post school education and training for work and life; and
- Australia has a strong science, research and innovation capacity and is engaged internationally on science, education and training to advance our social development and economic growth.

6.119 The Department's key business processes relate to:

- the administration of grant payments for infrastructure, education and training and research;
- delivery of services, which provide access to education and training assistance; and
- the provision of expert advice and analysis to the Government.

6.120 The Department is predominantly budget funded and its appropriations for the 2002–2003 financial year comprise:

- price of outputs—$234.9 million; and
- administered appropriations—$13.66 billion.

6.121 The Department's average staffing level for 2002–2003 is 1394 across Australia.

Key business and financial statement risks

6.122 In order to manage its business risks, the Department addresses key issues relating to:

- the Minister's reputation and trust;
- the Secretary's accountability;
- staff safety and security;
- integrity of data, processes and information; and
- strategic priorities.

6.123 In managing these business and financial risks, disciplined management and operational policies, practices and procedures are required over policy advising and program management activities and grant administration.

6.124 The ANAO's assessment of the risk of material misstatement in the 2002–2003 financial statements is moderate. Key issues for the current year include:

- the recognition of unfunded superannuation liabilities;
- accounting for the Higher Education Contributions Scheme;
- the adequacy of systems and processes to allocate costs against agreed goods and services (outputs) and resulting benefits (outcomes); and
- the absence of timely reconciliations between systems.

6.125 The financial statement audit will focus on the material financial reporting issues flowing from the significant business risks and key business and accounting processes, including the above issues.

Corporate governance

6.126 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors that management considers necessary to achieve them. Measures that impact on financial assurance include:

- the Department's corporate direction as outlined in the corporate plan, with short-term priorities being assessed on an annual basis and reflected in the business plans of each work unit;
- the Department's progress in meeting its goals and objectives are measured and monitored by the Corporate Leadership Group (CLG). The CLG monitor financial and non-financial performance and review monthly financial management reports;
- the establishment of a Corporate Committee to take care of the corporate governance of the Department;
- a strategic risk management plan and risk assessment process, developed through the Parliamentary, Assurance and Legal Group. The plan takes into account the high priority risks and risk minimisation strategies identified by all divisions and links the critical success factors set down in the corporate plan;

- the Audit and Business Assurance Committee (ABAC) which meets quarterly and actively focus on the internal and external audit. All audit reports and audit plans are approved by the ABAC based on their assessment of risk and coverage required;
- an internal audit plan that addresses key business risks and covers all programs administered by the Department;
- a monthly reporting regime that reports actual versus budgeted departmental and administered activity across the Department's outputs and outcomes. Included in this process is an analytical review of performance with commentary; and
- a fraud control plan which provides details on fraud control strategies, fraud detection policies/procedures and investigation.

Financial reporting

6.127 The Department is developing its financial reporting process in order to meet better practice. The Department produces a suite of internal management reports that provide different levels of detail, comparative information and commentary for the Corporate Leadership Group.

Audit results

6.128 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	3	3	2	2
Total	**3**	**3**	**2**	**2**

General audit findings

6.129 Controls over accounting and financial processes were found to be generally satisfactory. The following deficiencies were noted:

- there is no Service Level Agreement in place between the Department and the Australian Taxation Office (ATO), regarding the management of collection and recording of moneys for the Higher Education Contribution Scheme; and
- no action has been taken to recover a receivable from 2001–2002 for approximately $19.5 million in relation to ABSTUDY payments processed by Centrelink.

Conclusion

6.130 The Department continues to strengthen its internal control structure with further gains made in the past year on the quality of its internal control environment including financial reporting.

Department of Employment and Workplace Relations

Business operations

6.131 The aims of the Department of Employment and Workplace Relations (the Department) are to maximise the ability of unemployed Australians to find work—particularly those that face most severe barriers to work; and support strong employment growth and the improved productive performance of enterprises in Australia. The Department's most significant business process is the management of contracts associated with the employment program.

6.132 The Department contributes to the achievement of two Government outcomes, namely:

- an effectively functioning labour market; and
- higher productivity, higher pay workplaces.

6.133 The *Workplace Relations Legislation Amendment Act 2002*, of 11 December 2002, amended the *Safety, Rehabilitation and Compensation Act 1998*, the *Seafarers Rehabilitation and Compensation Act 1992* and the *Seafarers Rehabilitation and Compensation Levy Collection Act 1992* resulting in the transfer of operational responsibility for the Seafarers Safety, Rehabilitation and Compensation Authority from the Department to Comcare within the subsequent six month period.

6.134 The Department's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$448.7 million; and
- administered appropriations—$1,287.4 million.

6.135 The Department's average staffing level is 1971 across Australia.

Key business and financial statement risks

6.136 In order to manage its business risks, the Department addresses key issues relating to:

- contract management—in delivering employment programs, the Department relies on contractors and other Government agencies. A strong contract management framework must be in place to ensure the delivery of a range of programmes. Previous audit coverage has found the contract management financial framework to be sound. Critical elements include legal and probity issues associated with tender selection, contract management and performance monitoring. This is particularly relevant in 2002–2003 with the transition to the third Employment Services Contract (ESC3);

- policy advice and analysis—policy advice given by the Department to its ministers and other stakeholders must be accurate, timely and relevant;
- program administration and output delivery—the Department's ongoing relationships with its varied stakeholders is extremely important. These relationships must be managed effectively to ensure Government outcomes are achieved and its external accountability obligations are satisfied;
- downturn in the economy—the demand for the Department's services may increase with a downturn in the economy. The Department continually monitors relevant labour market factors and the level and quality of employment services;
- changes in legislation—the transfer of the Seafarers Safety, Rehabilitation and Compensation Authority from the Department to Comcare following the changes to the *Safety, Rehabilitation and Compensation Act 1998*, the *Seafarers Rehabilitation and Compensation Act 1992* and the *Seafarers Rehabilitation and Compensation Levy Collection Act 1992* of 11 December 2002, means that the process will have to be managed to ensure the delivery of services is not compromised, and the restructure arrangements are accurately reported in the financial statements; and
- IT systems and policy changes—the Department is heavily dependent on the effectiveness and integrity of IT systems for program delivery. The Department must manage its critical IT systems to ensure they meet the changing needs of the Department and provide accurate and timely information.

6.137 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements has been assessed as moderate. Key areas where the adequacy of the control framework will be reviewed include:

- reporting of administered and departmental items against their correct classifications;
- contract management arrangements;
- reporting financial outcomes and outputs; and
- changes to financial reporting requirements.

6.138 The ANAO financial statement audit will focus on the material financial reporting risks flowing from the major business risks and key business and accounting processes, including the above issues.

Corporate governance

6.139 The Department continues to have in place important elements, which contribute to sound corporate governance and in particular to financial statement assurance. Measures which impact on financial statement assurance include:

- a corporate planning framework, which has a strategic risk assessment process covering the main areas of business, including the assessment of group and state business plans and the allocation of resources;
- executive/management arrangements charged with monitoring business planning processes, monthly evaluations of key performance indicators, budgets and other financial and nonfinancial measures;
- a committee framework that includes: a management board and supporting subcommittees including, people and leadership, audit, remuneration, ethics and the newly formed IT subcommittee;
- a reporting regime, which includes a monthly accrual financial report that provides the executive and operational areas with key financial information;
- a review and monitoring framework, including a strategic internal audit plan and an annual internal audit work plan approved by the Audit Subcommittee and endorsed by the Secretary and Management Board; and
- a fraud control plan, which is incorporated into the Department's integrity plan 2001–2003. All major business areas conduct fraud risk assessments, which contribute to the development of fraud control action plans. The fraud control action plans, together with mandatory coverage required by the fraud control policy of the Commonwealth, form the Department's integrity plan.

Audit results

6.140 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised to date by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	8	6	3	5
Total	**8**	**6**	**3**	**5**

General audit findings

6.141 Controls over accounting and financial processes were found to be generally sound. A recommendation was made to improve the management and completion of the reconciliation processes of the Department to ensure the accuracy and completeness of the information contained in the general ledger for use in decision-making and the preparation of financial reports.

IT security

6.142 Overall, the Department has a sound security policy which is used to drive security processes and solutions throughout the Department. In order to improve documentation standards and to minimise the possibility of unauthorised access to systems, ANAO recommendations were made including:

- implementation of access settings around Windows 2000 to accord with Departmental policy;
- introduction of procedures to disable User ID's after set periods of inactivity; and
- implementation of formal security logging and privileged account usage reviews on two systems.

Business resumption planning

6.143 In order to ensure the uninterrupted availability of all key business resources required to support critical business activities, recommendations were made to ensure that the Department's business continuity plan and disaster recovery plan are completed as soon as possible.

Financial reporting

6.144 The Department has implemented a strong financial management process that provides monthly reports to managers within five days of the end of each month. The reports provide actual performance against budget information on an accrual basis allowing management to assess the financial position and operating performance of the Department. The reports are supplemented with a balanced score card reporting system, which reports against a range of financial and non-financial indicators, including client, business and people management needs and goals.

Conclusion

6.145 The Department continues to strengthen its internal control structure and is in a sound position to produce reliable information for its annual financial statements. The Department has agreed to implement all of the ANAO recommendations and has advised that the necessary action has been commenced.

Department of the Environment and Heritage

Business operations

6.146 Following the gazettal of regulations to the FMA Act, the Bureau of Meteorology (former Outcome 2 of the Department) became a prescribed agency on 12 September 2002. The Department of the Environment and Heritage (the Department) now consists of two autonomous units involved in operations as follows:

- *Environment Australia*—Environment Australia's objectives are the provision of advice on and implementation of policies and programs for the protection and conservation of the environment. This includes assistance to the Australian community to appreciate and conserve Australia's natural and cultural (indigenous and historic) heritage places for present and future generations.
- *Australian Antarctic Division (AAD)*—The AAD's objectives are the pursuit of Australia's Antarctic interests involving the protection of the Antarctic environment and the conduct of scientific research in the Antarctic, sub-Antarctic and the Southern Ocean. The AAD also promotes Australia's interests within the Antarctic Treaty System and administers the Australian Antarctic Territory, Heard Island and McDonald Islands.

6.147 The Department's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$291 million; and
- administered appropriations—$59.6 million.

6.148 The Department's average staffing level is 1150 across Australia.

Key business and financial risks

6.149 In order to manage its business risks, the Department addresses key issues relating to:

- *Environment Australia*
    - policy advice and analysis;
    - implementation of the new environment legislation;
    - public interest in activities; and
    - increased financial management responsibilities and accountability.

- *Australian Antarctic Division*
  - unique and changing nature of operations; and
  - increased financial management responsibilities and accountability.

6.150 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is moderate. Key issues include:

- Environment Australia
  - restructuring of the Department;
  - restructuring of the divisions within Environment Australia;
  - classification of IPEX IT lease;
  - reporting of the Office of the Renewable Energy Regulator; and
  - changing financial regulatory requirements.
- *Australian Antarctic Division*
  - changing financial regulatory requirements;
  - lack of full accrual based accounting and reporting systems; and
  - previous control weaknesses.

6.151 The financial statement audit will focus on the material financial reporting issues flowing from the significant business risks, business and accounting processes and the above issues.

Corporate governance

6.152 The ANAO's audit approach considers departmental goals and priorities, objectives, and strategies along with the critical success factors management considers are necessary to achieve them. Measures, which impact on financial statement assurance, include:

- a Senior Executive Committee (SEC) which meets regularly to evaluate and determine the Department's strategic direction, financial planning and operational results;
- an Audit Committee (DEHAC) that meets at least quarterly and acts as an advisory body on matters relating to internal audit, evaluation, fraud control and risk assessment. The Audit Committee includes two external members;
- the endorsement by the Audit Committee of the Strategic Audit Plan and the Annual Audit Plan. The plans identify available resources, address key business and financial risks and detail the rationale behind each audit;

- a documented risk management strategy (currently under review) which identifies and treats medium and high rated exposures;
- a fraud control plan and publication of fraud control arrangements and guidelines on the Department's intranet;
- the preparation and reporting of monthly financial data and reports for analysis and action by managers and the SEC; and
- the business practices employed by the Department, the skills and experience of financial and accounting staff and systems of authorisation, recording and procedures are adequate to support business operations.

Audit results

6.153 The following table provides a summary of the status of prior year issues and 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	2001-2002 Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
Environment Australia				
A	1	1	0	0
B	3	3	1	1
	4	**4**	**1**	**1**
Australian Antarctic Division				
A	0	0	0	0
B	0	0	1	1
	0	**0**	**1**	**1**
Department of the Environment and Heritage (combined total)*				
A	1	1	0	0
B	3	3	2	2
Total	**4**	**4**	**2**	**2**

* NB: The Bureau of Meteorology was previously included in this summary but became a prescribed agency on 12 September 2002 and now reports separately.

Environment Australia

General audit findings

Revenues

6.154 A control issue was raised in relation to the non-completion of three CAMM reconciliations between appropriation drawdowns and the SAP FMIS.

Australian Antarctic Division

General audit findings

Payment of expenses

6.155 A control exposure was noted with the accounts payable system, which allowed users to set up vendor and bank account details with no independent check to ensure these details were correct.

Financial reporting

6.156 The executive and operational areas are provided with financial information in relation to the Department's financial position and operating performance on a monthly basis. The reports provide results by outcome on a budget versus actual basis. In addition, the executive is also provided with reports in relation to cash management practices and investment results.

Conclusion

6.157 Control frameworks for both Environment Australia and the Australian Antarctic Division have improved during the past year and the Department is in a sound position to produce reliable information for its annual financial statements. The Department has responded positively to all of the ANAO's findings and recommendations for control improvements.

Department of Family and Community Services

Business operations

6.158 The Department of Family and Community Services (FaCS) is the principal policy formulation and advising body within the Family and Community Services portfolio. According to ministerial requirements and within the relevant legislative framework, FaCS is responsible for income support, housing policy, community support, child care services and family issues, including family payments, child support and family relationships. As well as families, FaCS focuses on groups with differing needs, such as young people and students, people living in rural and remote areas, Aboriginal and Torres Strait Islander peoples and people from diverse cultural and linguistic backgrounds.

6.159 FaCS advises the Government on all policy issues within the portfolio and manages the delivery of departmental services through a range of service providers, including Centrelink, State and Territory governments and state-based Non-Government Organisations (NGOs). FaCS also advises the Government on the social policy implications of wider government policy including taxation, superannuation and savings policy.

6.160 FaCS' appropriation funding for the year ended 30 June 2003 year comprises:

- price of outputs—$2 422 million; and
- administered appropriations—$57 923 million.

6.161 FaCS' average staffing level is approximately 4000 across Australia.

Key business and financial statement risks

6.162 FaCS focuses on the following issues to ensure that the business risks they face are adequately addressed:

- integrity of outcomes and outlays, including through service providers;
- provision of quality and timely policy advice;
- adequate management of service providers and other stakeholders;
- compliance with legislative requirements;
- human resource management; and
- continuity of business, including knowledge management.

6.163 In managing these business risks, disciplined governance, management and operational policies, practices and procedures are required over the adequacy of business management arrangements across FaCS. This involves the maintenance of financial, human resource management and other corporate systems.

6.164 In view of the above and based ANAO analysis of FaCS' business processes, control environment, business risks and consideration of financial reporting requirements, FaCS' overall exposure to financial statement misstatement has been assessed as moderate.

Corporate governance

6.165 FaCS' corporate governance regime has strengthened over the past year. Previously, the ANAO raised concerns in relation to the overarching risk framework and supporting risk management initiatives covering the Department and its service providers, particularly Centrelink. Significant effort has been focussed on the development and implementation of an overarching risk framework over the past few years. This is a continuing process. The momentum and focus needs to be maintained to ensure that appropriate improvements are made to the current framework. Continuation of work in conjunction with Centrelink on risk management initiatives including customer profiling and analysis of the rolling random sample survey results should enable specific areas to be targeted to improve compliance and payment accuracy.

6.166 The Risk Assessment and Audit Committee (RAAC) meets quarterly and is focused on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes, audit planning and reporting.

6.167 The Executive Board takes an active interest in the financial operations of FaCS and receives monthly detailed reports from the Chief Financial Officer (CFO), who is a Board member.

6.168 FaCS has a fraud control plan that covers the period 1 July 2002 to 30 June 2004. The fraud control plan outlines the functional activity, risk event, risk rating and strategies/treatment required and the timing to complete any treatment action and responsibility. The fraud risk assessment is updated every two years in the form of a survey that is sent to all FaCS Branches.

6.169 FaCS has developed a risk management framework which requires all staff to assess their risks and to develop a risk management plan for their area as part of the strategic and business planning process. All areas are required to show via their risk management plans that they have identified the risks associated with achieving their priorities and that they are actively managing their risks.

Audit results

6.170 The following table provides a summary of the status of prior year issues for FaCS and CSA, in addition to 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	4	4	6	6
Total	**4**	**4**	**6**	**6**

General audit findings

Delegations and authorisations in CUBA

6.171 To manage risk effectively, the Child Support Agency (CSA) identified a number of key transactions in the administered FMIS that required dual authorisation. However, the FMIS currently permits the processing of some transactions with a single authorisation. As well, the FMIS does not enforce delegation limits.

Leave not recorded in the HRMIS

6.172 Numerous instances were identified where the HRMIS did not reflect all leave taken by staff.

Management of assets under construction

6.173 FaCS needs to review their current procedures around the management of, and accounting for, assets under construction. A number of issues were highlighted during the audit, including the incorrect capitalisation of expense items and the allocation of costs to the wrong projects.

IT security

6.174 During 2001–2002, FaCS developed a sound IT security policy. However, this policy is yet to be approved by executive management. Overall, FaCS has established appropriate policies and procedures to ensure integrity of financial information. However, a weakness was identified regarding the lack of monitoring of privileged access to the HRMIS.

Business resumption planning

6.175 FaCS has in place a well defined business continuity management framework. Within this framework, CSA is responsible for its own business continuity plan (BCP). CSA is currently in the process of updating their BCP and does not have a fully tested IT & Telephony Disaster Recovery Plan.

Financial reporting

6.176 FaCS has an effective and strong financial reporting regime in operation. The current regime includes monthly reporting to the Board on actual results against budget, including an analysis of any variances, percentage of year to date budget utilised, and a performance scorecard. The performance scorecard incorporates both financial and non-financial measures of FaCS' current financial position.

Conclusion

6.177 FaCS has made progress in strengthening its control environment, however, issues have been highlighted which should be addressed. FaCS should focus on the outstanding issues and work towards the timely resolution of these matters to strengthen further their control environment.

Centrelink

Business operations

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

6.179 Centrelink's customers include retired people, families, sole parents, unemployed people, people with disabilities, illnesses or injuries, carers, widows, primary producers, students, young people, indigenous people and people from diverse cultural and linguistic backgrounds.

6.180 Centrelink operates under a purchaser/provider framework and obtains the majority of its funding through business partnership arrangements, on a fee for service basis, with client entities that purchase Centrelink's services.

6.181 Centrelink's price of outputs for the year ending 30 June 2003 is $2030 million.

6.182 Centrelink operates an extensive customer service centre network across Australia and its average staffing level is approximately 23 750 people.

Business and financial statement risks

6.183 To ensure key business risks are addressed, Centrelink focuses attention on the following areas:

- voluntary disclosure;
- service delivery;
- complexity and dynamics of IT environment;
- welfare reform; and
- managing key external relationships.

6.184 The current framework requiring voluntary disclosure by customers heightens the risks associated with ensuring accurate payment and assessment of personal benefits. Centrelink needs to ensure that appropriate controls and strategies are in place to mitigate this risk to the extent possible and encourage timely disclosure by customers.

6.185 In view of the above and based on ANAO analysis of Centrelink's business processes, control environment, business risks and consideration of financial reporting requirements, Centrelink's overall exposure to financial statement misstatement has been assessed as moderate.

Corporate governance

6.186 The ANAO's audit approach considers the strength of Centrelink's control framework in managing the business and financial risks associated with key initiatives undertaken to meet service delivery needs. Key elements of Centrelink's control structure which contribute positively to financial statement assurance are outlined below.

Board of management

6.187 The Management Board determines the organisational strategy and provides guidance and oversight to senior management in the delivery of Centrelink's service charter. The Board also reviews overall business strategies, plans and significant policies to ensure that Centrelink fulfils its obligation to client agencies and other stakeholders.

Corporate and business strategy

6.188 A five year corporate and business strategy is supported by a national business plan that details how the strategies outlined will be achieved. This provides the basis for a range of other plans within the organisation.

Monthly financial reporting

6.189 A reliable and comprehensive monthly accrual based financial reporting regime includes statements of financial performance and position, cashflow, analysis of actuals to budget, key statistics and the integration of non-financial performance information.

Audit committee

6.190 An Audit and Risk Committee of the Board, chaired by an independent member, ensures Centrelink operates with appropriate financial management and complies with established internal controls by reviewing specific matters that arise from the audit process. The Audit and Risk Committee takes an active role in overseeing the agency's accounting, financial reporting and external audit through quarterly reports from the Chief Financial Officer and the Chief Internal Auditor.

Internal audit

6.191 The internal audit function undertakes a program of audits covering the main aspects of Centrelink's business. The audit committee approves the internal audit program.

Fraud control

6.192 The fraud control action plan addresses fraud associated with welfare payments (payment fraud), benefits as a result of information held by Centrelink (information fraud) and Centrelink's assets, financial and human resources (administrative fraud).

Chief Executive Instructions (CEIs)

6.193 Centrelink's CEIs are up-to-date and provide the framework for Centrelink's financial operations.

Review and monitoring framework

6.194 Centrelink maintains a review and monitoring framework which includes an assessment and compliance review of benefit payments.

Risk management

6.195 Previously, the ANAO raised concerns in relation to the development and implementation of Centrelink's high level risk management framework. Significant effort has been focussed on the development and implementation of an overarching risk framework over the past few years. This is a continuing process. The momentum and focus needs to be maintained to ensure that appropriate improvements are made to the current framework. Continuation of work in conjunction with Department of Family and Community Services on risk management initiatives including customer profiling and analysis of the rolling random sample survey results should enable specific areas to be targeted to improve compliance and payment accuracy.

Audit results

6.196 The following table provides a summary of the status of prior year issues for Centrelink as well as 2002–2003 audit issues raised by the ANAO during its interim audit procedures.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	3	2	4	5
Total	**3**	**2**	**4**	**5**

General audit findings

Payment discrepancy resolution

6.197 The System Support Groups (SSGs) perform the function of reviewing any records which are produced as exceptions from the payment reconciliation process. During the interim audit, the ANAO noted numerous payment discrepancies that had not been investigated or resolved by the SSGs. This creates the risk that outstanding records may be left unmonitored which could result in overpayments not being recouped.

Segregation of duties

6.198 Centrelink employs a software tool to verify the integrity of payment files before they are sent to the Reserve Bank of Australia for processing. The ANAO identified a lack of segregation of duties surrounding the development and implementation into production of changes to the software tool. This creates the risk that transactions requiring further investigation (highlighted by the software tool) will be released for payment.

Verification of delegates signatures

6.199 A key control at Centrelink is that an invoice is only to be paid after an appropriate delegate has approved the purchase. A signature on a paper form may be used as evidence of this approval. No verification is performed to ensure that the signatory is a delegate authorised to approve expenditure of public monies. Centrelink is exposed to an increased risk of payments being made for unauthorised purchases.

IT business processes

Inconsistent application of change control practices

6.200 The ANAO's review of change management processes over the past two years has noted significant improvements in the controls and oversight of changes made to key systems. Staff accountability has improved through the establishment of the Change Control Board and the use of system change requests and system certification processes and checklists.

6.201 However, the interim audit identified a number of control deficiencies within Centrelink's change control practices. These deficiencies could result in a reduction of the integrity of key transactional and financial applications.

IT security

Inappropriate Access to Financial Management Information System (FMIS)

6.202 The interim audit highlighted a number of instances where access to functions within the FMIS was retained by users who no longer required such access. In addition, a number of users were found to have access to general ledger functions which were not commensurate with their duties. This issue results in a reduction in the integrity of key transactional and financial applications.

Financial reporting

6.203 Centrelink has a monthly financial reporting regime, which includes comparison to budget, variance analysis and commentary. All reports are prepared on a full accrual basis. The Business Analysis and Reporting Team prepare financial analysis and commentary and National Managers and Team Leaders receive this report on a monthly basis and must provide commentary for variances between budgets and actual. In addition, Centrelink utilises a balanced scorecard to report on progress against key performance indicators.

Conclusion

6.204 The control framework over Centrelink's significant business processes are operating effectively and can be relied upon for the production of accurate, complete and valid financial statement information. Centrelink should focus on issues outstanding and work towards the timely resolution of these matters to further strengthen its control environment.

Department of Finance and Administration

Business operations

6.205 The role of the Department of Finance and Administration (Finance) is to assist the Government achieve its objectives by providing policy advice and services. The Department accomplishes this by contributing to three key outcomes:

- sustainable government finances;
- improved and more efficient government operations; and
- an efficiently functioning Parliament.

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

6.207 Finance has continuing outsourced arrangements in place for the provision of human resource management, Commonwealth financial reporting, internal audit, office services, IT services, property portfolio management and Comcover's client services.

6.208 There have been no significant changes in the functions carried out by Finance since the Administrative Arrangements Order (AAO) of 26 November 2001.

6.209 Finance's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$363 million, $127 million of which is funded by appropriations; and
- administered appropriations—$4698 million.

6.210 Finance's budgeted average staffing level for 2002–2003 is 788.

Key business and financial statement risks

6.211 In order to manage its business risks, Finance addresses key issues relating to:

- appropriateness and rigidity of Commonwealth financial management framework;
- appropriateness and accuracy of advice provided to Ministers, Members of Parliament and departments;

- valuation of superannuation liabilities administered on behalf of the Commonwealth;
- valuation of insurance liabilities administered on behalf of the Commonwealth and the appropriateness of asset cover and reinsurance policies;
- valuation of Commonwealth domestic property portfolio and adequacy of asset management procedures;
- validity and accuracy of entitlements paid to parliamentarians and their staff; and
- appropriateness of contract management procedures over outsourced arrangements for the provision of human resource management, Commonwealth financial reporting, internal audit, office services, IT services, property portfolio management and Comcover's client services.

6.212 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is at the medium level. Key issues for the current year include:

- accounting for the actuarial assessment of the public sector unfunded superannuation liability;
- accounting for asset management; and
- reliability of valuations provided from third parties for assets and liabilities, particularly for Comcover.

6.213 The financial statement audit will focus on the material financial reporting issues flowing from the significant business risks and key business and accounting processes, including the above issues.

Corporate governance

6.214 Finance has in place structures and processes that contribute to effective corporate governance and, in particular, to gaining assurance over the financial statement process. Specific processes assisting Finance in achieving this assurance include the following:

- annual internal audit work program approved by the audit committee;
- business planning and budget processes;
- defining policy and procedures to operate within legal and social requirements;
- establishing control and accountability systems;

- regular updating of the audit committee charter;
- the finance managers' committee and weekly meetings with Finance's chief financial officer;
- reviewing, monitoring and evaluating Finance's performance; and
- risk management and the establishment of a risk management coordination unit.

6.215 These processes are exercised by management and articulated to all staff within Finance.

6.216 Finance is currently in the process of developing a business continuity plan.

Audit results

6.217 Finance has resolved all financial reporting issues raised by the ANAO in previous years. At this time there are no significant issues arising from the 2002–2003 financial statement audit.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	0	0	0	0
Total	**0**	**0**	**0**	**0**

6.218 The results of the audit to date indicate that Finance has continued to take a pro-active role towards maintaining a strong system of internal controls.

Financial reporting

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

6.220 During 2001–2002 Finance managed the 'close the books' process successfully. In order to facilitate meeting of the 15 August 2003 deadline, comprehensive financial statement instructions detailing procedures and a timetable were distributed to appropriate Finance line managers in March 2003. Finance is well placed to meet effectively the reporting timeframe for 2002–2003.

Conclusion

6.221 ANAO has noted continued refinement of corporate governance and control structures in place. In relation to the current audit cycle, based on the work performed to date, the control framework and the internal controls are operating satisfactorily.

Department of Foreign Affairs and Trade

Business operations

6.222 The Department of Foreign Affairs and Trade (the Department) is responsible for protecting and advancing Australia's interests internationally by: enhancing international security, national economic and trade performance, and global cooperation; providing consular and passport services to Australian citizens; projecting a positive and accurate image of Australia internationally; promoting public understanding of Australia's foreign and trade policy; and managing overseas property owned by the Commonwealth Government.

6.223 The Department provides high quality advice to the Government across the spectrum of foreign and trade policy issues. It assists the increasing number of Australian travellers and Australians overseas, and projects a positive image of Australia internationally. The Department's work towards its four outcomes is carried out by staff serving at its network of overseas posts as well as in Canberra, in State and Territory capitals and in some regional centres.

6.224 The Department's principal appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$778.2 million; and
- administered appropriations—$212.0 million.

6.225 The Department's average staffing level for 2002–2003 is expected to be 3167 in Australia and overseas.

Key business and financial statement risks

6.226 In order to manage its business risks, the Department addresses key issues relating to:

- the delivery of timely and effective policy advice in line with the government's and ministers' agenda;
- maintaining effective relations with other countries and the ability to influence global and regional developments to protect Australia's interests;
- maintaining a secure and effective overseas network;
- meeting client expectations and demands for consular and passport services, including the requirement to have continued security over passport operations; and
- valuation of the Commonwealth's overseas property portfolio and adequacy of asset management procedures.

6.227 In managing these business risks, disciplined governance arrangements and management practices are required over foreign and trade policy and related diplomatic activities. Integral to this are human resource, IT, financial and corporate management processes and systems that support a large network of overseas posts.

6.228 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is at the medium level. Key issues for the current year include:

- the recoverability of debts on the National Interest Account; and
- valuation of overseas property and associated depreciation as a result of a change from the deprival method to a market based method of valuation.

6.229 The financial statement audit will focus on the material financial reporting risks flowing from the significant business risks, business and accounting processes, including the above issues.

Corporate governance

6.230 Generally, a strong corporate governance regime imposes an alignment in the authority, responsibility and accountability within an entity. Aspects of the Department's corporate governance arrangements which impact on financial statement assurance include:

- an executive committee which oversights the operational performance of divisions; reviews departmental wide issues and monitors financial performance;
- the preparation of monthly financial data and reports for the Secretary. Currently divisions and overseas missions monitor their financial information. The consideration of long-term issues would be enhanced through the development of more comprehensive guidelines on the level and type of regular financial information analysis;
- an audit committee which meets quarterly and focuses on the efficiency, effectiveness and probity of activities including risk assessment and management, internal audit planning and results, fraud control and ANAO audit activities; and
- an internal audit function which undertakes a program of audits in central office, and across the overseas network, in accordance with an approved plan, developed on a risk assessed basis.

6.231 The Department is currently revising its risk management plan. This will assist in strengthening the risk identification, assessment and prioritisation processes including the implementation or refinement of controls to minimise risks to acceptable levels.

Audit results

6.232 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved as at 31 March 2003	New issues raised at interim 2003	Closing position as at March 2003
A	0	0	0	0
B	1	1	1	1
Total	**1**	**1**	**1**	**1**

6.233 The results of the audit indicate that departmental systems and procedures have the capacity to produce accurate and complete information for financial reporting purposes.

Change management

6.234 The Department has been active in enhancing its overall control structure resulting in improvements in IT security and the quality of financial information and reporting. A weakness existed with the management of changes to the human resource system and the general ledger system. Changes were not always adequately documented or reviewed. Access had been granted to both development and production data environments without a process to monitor the usage of privileged access. The Department has implemented procedures to rectify this situation.

Financial reporting

6.235 The Department has maintained a strong focus on continuously improving the quality of its financial information and reporting systems and processes covering an extensive overseas network. Improvements are expected to continue in the quality of financial reporting and analysis as the Department continues to integrate accrual based financial information into its management and decision making processes.

Conclusion

6.236 The Department has strengthened its financial reporting and internal control structure and has responded positively to ANAO findings and recommendations.

Department of Health and Ageing

Business operations

6.237 The vision of the Department of Health and Ageing (the Department) portfolio is better health and healthier ageing for all Australians through a world class system which:

- meets people's needs, throughout their life;
- is responsive, affordable and sustainable;
- provides accessible, high quality service including preventative, curative, rehabilitative maintenance and palliative care; and
- seeks to prevent disease and promote health.

6.238 The Department's role is to lead the development of Australia's health and ageing system, to ensure world-class care for all Australians. The Department's key business goals are:

- improving the delivery of high quality health services for all Australians where and when they need them;
- encouraging healthier living through measures to prevent and reduce the severity of diseases and injury and known health risks;
- integrating care for consumers, through evidence-based care with improved linkages between primary, acute and community care;
- ensuring choice and access to appropriate community based and residential aged care services for older Australians, support for carers and industry, and a whole-of-government approach to the challenges of an ageing Australian population;
- improving choice through strong and viable public and private health sectors, in which people have access to affordable private health care; and
- responding to emerging pressures, including from new technology and pharmaceuticals, in ways that improve care but contain costs.

6.239 In order to achieve the above goals, the Department:

- provides expert policy advice, analysis and other services to the Government;
- works with Portfolio agencies, State and Territory governments, professional organisations, industry groups, peak bodies, providers and consumers through consultation and collaboration;

- manages the Commonwealth's health and ageing Programs to ensure the provision of quality, cost effective care; and
- safeguards health, safety and equity, in a way that imposes minimal regulatory burden.

6.240 CRS Australia, Therapeutic Goods Administration (TGA), National Industrial Chemicals Notification and Assessment Scheme (NICNAS) and the Office of the Gene Technology Regulator (OGTR) form a key part of the Department and are also included within the Department's consolidated financial statements.

6.241 The Department's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$773 million (including amounts paid to HIC); and
- administered appropriations—$30.4 billion.

6.242 The Department's average staffing level for 2002–2003 is projected to be 5055.

Key business and financial statement risks

6.243 In order to manage its business risks, the Department manages key issues relating to:

- addressing health and ageing priorities before and as they emerge;
- promoting health, including preventative health measures that contribute to the long term sustainability of the health system;
- the delivery of timely and appropriate health care policy which ensures adequate health services are available to all Australians;
- compliance with grant funding agreements and Commonwealth specific health and aged care related legislation;
- management of systems and programs relating to delivery of a wide range of services; and
- public perception of the Department.

6.244 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements has decreased from high in 2001–2002 to moderate to high in the current year. Key issues for the current financial year include:

- the Departments internal restructuring and implementation of new governance arrangements;

- monitoring and reconciliation of funds disbursement;
- information transfer from feeder systems into the FMIS;
- complex calculations of payments made to State & Territory Governments service providers and program recipients;
- compliance with all relevant legislation and agreements by the Department and recipients;
- accounting and reporting the Government's commitment to the Medical Indemnity Scheme; and
- the transfer of CRS Australia to the Health portfolio.

6.245 The financial statement audit will focus on the material financial reporting issues flowing from the significant business risks and key business and accounting processes (including the above issues).

Corporate governance

6.246 A new corporate executive structure was established during the current financial year as part of the Department's continued development and implementation of improved governance arrangements. The new structure is designed to more tightly align key departmental objectives, and in particular manage the many cross-cutting issues, in a more systematic manner. Governance measures which impact on financial statement assurance include:

- a corporate plan, which sets the broad strategic direction for the Department and is supported by divisional business/operational plans which detail activities and associated resourcing and performance information;
- an Executive Committee (supported by two sub committees) which is chaired by the Secretary and assesses the overall performance of the Department's operations;
- an Audit Committee with an independent member appointed from outside the Department that meets at least quarterly and which focuses on risk assessment, internal audit activities, external audit activities, and fraud control;
- a monthly reporting regime, through the Business Management Committee (BMC), which reports actual versus budgeted departmental and administered activity;
- an Audit and Fraud Control Branch (AFC) with primary responsibility for internal scrutiny within the Department and operates under the broad

direction of the Audit Committee. The main goal of the Branch is to promote and improve the Department's corporate governance arrangements through the conduct of audits and investigations, and the provision of independent assurance and advice;

- a departmental risk management plan which is coordinated by the Business Group across the Department. The Executive Committee will be seeking to endorse a new risk management framework along with the movement towards a rolling assessment of fraud under the new Commonwealth Fraud Control Guidelines; and
- promotion by the AFC of ethics awareness and risk awareness.

6.247 The Department has developed a number of mechanisms to address matters raised in prior year audits, and this has resulted in positive progress being made in the current financial year. The operation and effectiveness of these measures are subject to ongoing review by the Department and the ANAO.

Audit results

6.248 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	5	4	4	5
Total	**5**	**4**	**4**	**5**

General audit findings

General ledger reconciliation process

6.249 The reconciliation of the financial reporting general ledger system to underlying business process systems is an important control in the Department's overall governance of the financial information framework underlying the primary financial statements. Timely and appropriate reconciliation ensures:

- data from underlying systems is accurately reflected in the financial statements;
- reported financial information is supportable; and
- identification of transaction processing discrepancies or systems being inappropriately accessed.

6.250 Significant improvement has been made by the Department in recent years with respect to the quality, timeliness and completeness of the general ledger reconciliation process. Overall, the process is considered satisfactory. ANAO have however observed isolated instances where the reconciliation process has been unsatisfactory and consequently recommended to management that the controls and procedures adopted by the remainder of the Department in relation to reconciliations, in line with the requirements of the Department's CEIs, be observed by all First Assistant Secretaries.

Inability to verify authorisation of payments by a delegate

6.251 Authorisation to make a payment by a delegate is a key control in the accounts payable process. In testing the authorisation controls residing within the expenditure cycle at Central Office, the audit identified an inability to readily verify a significant portion of expenditure authorisations to validate the effective operation of the approval control. The inability to validate authorisation controls over the expenditure cycle limits the level of assurance the Department has with respect to ensuring an appropriate delegate has approved the expenditure of public money.

Importantly, the Department has sought to address this process deficiency through the implementation of improved electronic workflow approval procedures from February 2003. This will be subject to audit verification as part of the financial year end audit.

Grant administration acquittal process

6.252 The Department makes grant payments to various Aboriginal and Torres Strait Islander health organisations. On an annual basis a full acquittal of each grant is performed which includes the receipt of an independent audit report, audited financial statements, a certificate from the organisation receiving funding stating that the funds have been used for the purposes provided and that the terms and conditions of the funding agreement have been complied with. In the current audit year ANAO have reviewed the annual acquittal process for the 2002 year and identified a limited number of funding agreements that have not been acquitted in accordance with the Department's guidelines. The acquittal process is an important control over the management of funding agreements and we have recommended to management that all acquittals be completed within the approved timeframe established by the Department.

IT security

6.253 The Department has attained a *Defined Process* rating for their information security practices. An area for further improvement is the establishment of adequate procedures to ensure network and application access for terminated employees is disabled on a timely basis. Overall, access security is assessed as adequate to enable reliance on key systems as part of the financial statement audit.

IT systems development

6.254 The Department has attained a *Defined Process* rating for their change management. Areas for improvement include requiring all Health IT development projects to comply with the IT project lifecycle methodology and quality assurance framework. Compliance should be extended to all outsourced projects. The methodology should be scaleable based on size and risk to ensure effective and efficient application of the framework. In addition, the related user manuals and documentation should be updated to reflect changes in system functionalities.

Business resumption planning

6.255 The Department has attained an *Repeatable but Intuitive* rating for their business continuity management practices. Management are aware that current practices require formal development and have undertaken a risk assessment to facilitate the development of adequate business continuity and disaster recovery plans.

Financial reporting

6.256 The Department continues to refine and make improvements in the financial reporting process. The Department produces full accrual monthly management financial reports within six days of the end of each month, which provide information on administered and departmental revenues, expenses, assets, liabilities, cashflows and reporting by outcomes. These are distributed to the Executive and Business Management Committee on a monthly basis. Included with these reports is commentary on the Department's financial position, including detailed variance analysis.

6.257 The financial reports are supplemented by non-financial reports produced quarterly, but these are not integrated in any way. Non financial reports are primarily focussed on budget initiatives and are reported by Outcome. Key Performance Indicators (KPI) are reported at a corporate level annually, but are monitored throughout the year at a divisional level. The KPIs are reviewed when each Division prepares their annual business plan.

Conclusion

6.258 The Department has continued to strengthen its internal control structure in the current financial year with further gains expected to be achieved with the implementation of the current business planning regime. Further improvement is still required in the areas of IT user access administration, general ledger reconciliations, business resumption planning, acquittal of grant funding and the approval of expenditure by delegates. The Department is however working towards the timely resolution of outstanding control matters and adopts a positive approach to addressing financial statement audit feedback.

Health Insurance Commission

Business operations

6.259 The Health Insurance Commission (the Commission) is a Commonwealth statutory authority that supports the delivery of quality health care to Australian residents. This is achieved by providing the Australian community with convenient access to government benefit and grant payments. Among the Commission's main activities are the administration of Medicare and the Pharmaceutical Benefits Scheme (PBS) on behalf of the Department of Health and Ageing (DoHA), and the 30 percent Private Health Insurance Rebate (PHIR).

6.260 The Commission also administers a number of health incentive programs and grant schemes on behalf of DoHA and processes the payment of benefits for the Department of Veterans' Affairs (DVA) Treatment Accounts, and the Office of Hearing Services. It also assists in administering the Family Assistance program for the Department of Family and Community Services.

6.261 All Commission activities are conducted within the policy framework set by DoHA, DVA, and other relevant legislative requirements. The Commission focuses on the operational service delivery of the programs and payments within the policy and legislative framework.

6.262 In 2001-2002, the Commission received administered funding of $15 billion for benefit and other payments. The Commission also received $415 million in operational revenues for the processing of administered payments, and a further $9 million from other revenue sources. The cost of providing these services totalled $421 million.

6.263 The Commission had an average staffing level for 2001–2002 of 4465.

Key business and financial statement risks

6.264 In order to manage its business risks, the Commission addresses key issues relating to:

- identification and management of fraud and inappropriate practices;
- understanding and meeting customer needs;
- business improvement, including technology infrastructure and solutions;
- administration of the 30% Rebate Scheme;
- delivery of critical services by outsourced service providers; and
- management of service level agreements with other entities.

6.265 In managing these business risks, disciplined management practices are required over the management of the Commission's IT control environment and associated operating and accounting systems.

6.266 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is at the high level based on the results of interim testing and previously gained client knowledge. Key issues for the current year include:

- financial statement preparation;
- accounting for internally developed software;
- reduced reporting timetable;
- accuracy of data from feeder systems;
- validity and accuracy of PHIR payments;
- funding management;
- accrual calculations; and
- impact of proposed Medicare reforms.

6.267 The financial statement audit will focus on material financial reporting risks arising from identified significant business risks, and key business and accounting processes, including the issues noted above.

Corporate governance

6.268 The ANAO's audit approach considers the Commission's goals and priorities; objectives and strategies along with the critical success factors management believe are necessary to achieve them. In considering the Commission's strategies, the ANAO focused on the key initiatives in place to meet its objectives and the management of the business risks associated with those initiatives. Key elements of the control structure employed by the Commission to meet its corporate governance and financial statement assurance responsibilities include:

- the Commission's strategic plan including key performance objectives;
- regular board meetings;
- a framework of committees such as the audit committee, the fraud and service audit committee, business outcomes committee, human resource committee, remuneration committee and various management committees;
- monthly financial reporting of actual results against budget;

- a formal risk management policy;
- establishment of a risk management assessment and framework; and
- an internal audit function which acts as a review and monitoring tool extending to all operations and systems. The audit and risk assurance service branch conducts audits in accordance with an approved plan resulting from formal risk assessments as well as input from senior management.

6.269 These elements have been reviewed and it has been determined that they provide an effective framework for the attainment of the Commission's goals. However, it must be noted that, while the current framework is effective, there are still further opportunities for improvement.

Audit results

6.270 The following table provides a summary of the status of prior year issues as well as 2002-2003 audit issues raised to date by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	1	1	0	0
B	12	8	3	7
Total	**13**	**9**	**3**	**7**

General audit findings

Reconciliations

6.271 The ANAO has seen an improvement from prior years in the controls surrounding the reconciliation processes adopted by the Commission.

6.272 General ledger reconciliations are seen as an important management control to ensure the validity, accuracy and completeness of information contained in the FMIS. Currently, errors could remain undetected due to the number of incidences of failure to adequately complete reconciliations or to apply the appropriate level of diligence and review. In the absence of adequate attention being directed to the purpose and procedures required, the validity of the reconciliation process is limited.

Asset management and recording

6.273 Asset management and recording issues continue to be observed by the ANAO due to non-adherence to procedures and a lack of resources to ensure that processes set in place by management are competently implemented. Deficiencies include:

- inadequate review procedures, as per the Managing Director's Instructions, over asset management processes outsourced to IBM GSA to ensure that the Commission is only paying for the assets they are using; and
- not maintaining a central 'portable and attractive assets' register, as per the Commission's portable and attractive asset policy within the Managing Director's Instructions.

IT control environment

6.274 As in prior years, ANAO have assessed the IT general controls environment in order to evaluate relevant inherent and controls risks that may impact key business and financial statement data and processes. ANAO have focused on the areas of information security and change management.

6.275 Information security management in the Commission is generally well defined. However, security administration procedures are not sufficiently robust, over a significant period of time, to allow reliance when determining audit-testing procedures.

6.276 Change control mechanisms in the Commission were managed, measurable and reasonable to ensure that unauthorised or inappropriate changes to the key business systems do not occur.

Business continuity management

6.277 In the previous year, it was noted that business continuity management procedures had not been maintained and tested for a significant period of time. Management has now focused resources on improving business continuity management procedures. Currently, business continuity and disaster recovery plans are in the process of being updated in alignment with best practice and management have plans to regularly test and maintain these plans over time. However, at the time of the interim audit, these plans have not yet been fully developed and tested and may not sufficiently address all business continuity risks in the current audit period. As such, the business continuity management process has presently been assessed as informal.

Financial reporting

6.278 Improvements and enhancements have been achieved in the reporting of financial information to management and the Audit Committee. However, ANAO considers that further expansion in the depth of financial analysis, and inclusion of projected financial information should be pursued by the HIC.

Conclusion

6.279 The current internal control environment supporting the Commission's activities has many positive elements. However, immediate improvement in mainframe security access and control is required. Continued improvement is also required within the internal control structure to address remaining issues raised by the ANAO. In a number of cases, the Commission has already taken action to address aspects of the deficiencies identified by the ANAO. The Commission has advised that a continuing high priority has been placed on resolution of all matters brought to its attention.

Department of Immigration and Multicultural and Indigenous Affairs

Business operations

6.280 The Department of Immigration and Multicultural and Indigenous Affairs (the Department) is responsible for enriching Australia through the entry and settlement of people, valuing its heritage, citizenship and cultural diversity; and recognising the special place of Indigenous people as its original inhabitants. The Department's business is focused on managing the permanent and temporary entry of people into Australia, enforcing immigration law; successfully settling migrants and refugees; promoting the benefits of citizenship and cultural diversity; and working with other portfolio agencies and departments to advance the social, economic and cultural interests and status of Indigenous people.

6.281 The Department's principal appropriation funding for the year ended 30 June 2003 comprises:

- price of outputs—$876.0 million; and
- administered appropriations—$206.0 million.

6.282 The Department's average staffing level for 2002–2003 is expected to be 4313 in Australia and overseas.

Key business and financial statement risks

6.283 In order to manage its business risks, the Department addresses key issues relating to:

- the delivery of timely and effective policy advice in line with the government's and minister's agenda;
- the enforcement of immigration law in relation to all classes of visas, and entry and stay conditions;
- the identification and management of unauthorised arrivals including the administration of detention centres; and
- maximising the economic benefits of migration, tourism and full fee paying international students.

6.284 In managing these business risks, disciplined governance arrangements and management practices are required over policy and program management activities, including compliance and regulatory issues. Integral to achieving this requirement, is the provision of adequate support services including IT, contract management and financial and human resource management across an extensive network of offices in Australia and around the world.

6.285 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is medium. Key issues include:

- accounting for asset construction, upgrades and maintenance programs;
- accounting for large contractual arrangements including leased IT assets and detention centre management; and
- accounting for appropriation revenue in line with the pricing agreement with the Department of Finance and Administration.

6.286 The financial statement audit will focus on the material financial reporting issues flowing from the significant business risks, business and accounting processes, and the above issues.

Corporate governance

6.287 Generally, a sound corporate governance regime creates an alignment in the authority, responsibility and accountability within an entity, aspects of which are critical to the preparation of reliable financial statements. Corporate governance arrangements in the Department, which contribute to financial statement assurance, include:

- a Management Board which meets at least monthly to advise the Secretary on progress against the achievement of key departmental outcomes and related strategic and operational issues including risk management;
- a Finance Committee which meets monthly, to assist the Management Board by providing advice on expenditure and budget allocations;
- an Audit and Evaluation Committee which meets at least quarterly, focusing on risk management and the control environment, particularly relating to financial systems, accounting processes, audit planning and reporting. The committee regularly reviews performance and monitors achievements against internal audit plans;
- preparation of monthly financial reports for review and analysis by branches and the Executive;
- an internal audit strategy and plan which, within available resources, addresses key financial and business risks based on management priorities; and
- a Security Steering Committee, which meets regularly to develop, set and review IT and protective security policies and procedures.

Audit results

6.288 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues prior to March 2003	Closing position as at March 2003
A	0	0	0	0
B	14	11	3	6
Total	**14**	**11**	**3**	**6**

General audit findings

Compliance with required departmental procedures—overseas posts

6.289 The ANAO noted an overall improvement in compliance with required administrative procedures at overseas posts. However, during the visit to the Australian Commerce and Industry Office a number of deficiencies were noted. Of more serious concern was the level of non-compliance with a number of departmental procedural requirements relating to security and controls over public monies.

Fraud control plan

6.290 The Department does not have a up-to-date fraud control plan. The ANAO recommended that the plan be updated to ensure fraud risks are identified and appropriately addressed by the Department.

IT security

6.291 The ANAO noted that:

- regular reviews of users with privilege access to the FMIS are not occurring. The ANAO recommended that the Department undertake regular reviews to ensure the risk associated with privileged access is mitigated; and
- delays had occurred in the removal of access from employees who had left the Department. The ANAO recommended that the Department review their procedures to ensure the timely removal of staff access from IT systems.

Business resumption planning

6.292 The Department has not reviewed its Business Continuity Plan (BCP) since contingency planning for the Year 2000. Although components of the BCP are currently being reviewed, the exercise is not occurring within a Departmental framework and does not encompass all core business functions.

6.293 The ANAO also noted that the IT Disaster Recovery Plan, a component of the BCP, is missing key elements. In addition, no testing has been undertaken to verify that action to recover key systems and data would be successful in the event of a disaster.

Financial reporting

6.294 The Department has stable and efficient financial reporting processes. Improvements are expected to continue in the quality of financial reporting and the level of financial analysis as the Department upgrades the level of accrual accounting and financial management knowledge across the Department.

Conclusion

6.295 The Department has acknowledged the findings and initiated corrective action to ensure all ANAO recommendations are addressed.

Department of Industry, Tourism and Resources

Business operations

6.296 The Department of Industry, Tourism and Resources (the Department) is committed to promoting sustainable improvements in living standards for all Australians by working in partnership with business, and other stakeholders, to maintain and facilitate internationally competitive Australian industries. In addition, the Department advises the Government on measures to enhance the development of efficient and globally competitive industries.

6.297 The Department's appropriation funding for the 2002–2003 financial year comprises:

- price of outputs—$231 million;
- administered appropriations primarily for grant payments and subsidies—$931 million; and
- equity injections predominantly for the Industry Innovation Fund and loans to Rio Tinto—$105 million.

6.298 The Department's average staffing levels for 2002–2003 is estimated at 1433 across Australia.

Key business and financial statement risks

6.299 Key business and financial statement risks of the Department are:

- complexity of operations, (organisational structure and numerous types/conditions of grant payments);
- initiative for best practice and effective support service delivery;
- management of external perceptions;
- system changes to cater for legislative changes;
- retention and attraction of staff; and
- the maintenance of adequate processes and controls for the effective administration of grant and innovation programs.

6.300 In managing these risks, the Department has put strong emphasis on maintaining efficient program administration and providing timely and effective policy advice.

6.301 The ANAO's assessment of the risk of material misstatement in the 2002–2003 financial statements is at the medium level. Key issues for the year include:

- the classification of the Department's IT lease;
- the capture and reporting of commitments; and
- financial statements preparation and close processes.

6.302 The financial statement audit will focus on the material financial reporting risks flowing from the significant business risks and key business and accounting processes, including the above issues.

Corporate governance

6.303 The Department has an effective corporate governance framework which contributes to the management of the above risks, including:

- an audit committee which is responsible for overseeing the department's audit, evaluation, risk management and fraud control plans and policies. The Committee considers all internal and external audits and monitors the implementation of all accepted recommendations. In addition, the committee is also responsible for reviewing the financial management control framework;
- an internal audit function. The focus of the internal audit plan is to address key business and financial risks identified in the department's risk assessment processes;
- an overall departmental risk management plan and divisional risk plans. Various arrangements have been implemented in order to mitigate risks identified in the plans;
- a fraud control plan which is scheduled for review in late 2003;
- a set of chief executive instructions which are currently undergoing review and upgrade;
- business practices including, but not limited to, quality assurance reviews of transactions, monthly financial reports and the recruitment of appropriately qualified and/or skilled staff; and
- a series of improvement initiatives to strengthen current monthly reporting processes.

Audit results

6.304 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised to date by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	3	2	2	3
Total	**3**	**2**	**2**	**3**

General audit findings

Controls over processing claims

6.305 The submission of a photocopy of a claim form resulted in a duplicate claim for payment totalling $685 269, being recorded as an expense and liability in the Department's general ledger. The Department has accepted the ANAO's recommendation to strengthen the controls over the processing of claims for payment.

Business resumption planning

6.306 In response to an ANAO prior year finding, the Department has developed a Business Continuity Plan (BCP). However, to ensure the uninterrupted availability of the Department's financial system the BCP must include coverage of the hardware supporting that system.

IT security

6.307 Oracle databases are utilised by the Department to store critical financial data. The audit identified the potential for unauthorised users to obtain access to sensitive financial information and make unauthorised changes which could compromise data integrity.

Financial reporting

6.308 The Department has implemented a number of continuous improvement initiatives intended to rigorously update its current processes to foster timely, complete and accurate financial reporting. The quality of its current financial month end processes has been rated as fair moving to good. The Department's close the books framework and the effectiveness of its month end financial reporting have been rated as good.

Conclusion

6.309 The Department acknowledged the issues raised and is currently establishing processes and procedures to enhance its control framework.

Department of the Prime Minister and Cabinet

Business operations

6.310 The Department of the Prime Minister and Cabinet is responsible for providing:

- policy advice on economic, industry, infrastructure and environment issues; and effective servicing of the Council of Australian Governments (COAG);
- policy advice on social and women's issues, as well as administering on behalf of the government, a number of programmes, including Partnerships Against Domestic Violence and grants to non-government women's organisations;
- policy advice on international issues; and
- policy advice on parliamentary, machinery of government and legal and cultural issues; provision of a range of support services for government operations including coordination of Cabinet and Executive Council business; policy advice on coordination and promotion of national awards and symbols; coordination of government communications and advertising; administration of the Prime Minister's official establishments; and administration of the visits and hospitality programme.

6.311 The Department's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$47.561 million; and
- administered appropriations—$26.408 million.

6.312 The Department's average staffing level is estimated at 344.

Key business and financial statement risks

6.313 In order to manage its business risks, the Department addresses key issues relating to:

- the delivery of timely and effective policy advice and services in line with the government's and Prime Minister's agenda;
- coordination of policy advice on a whole of government basis, including identification of emerging issues; and
- maintenance of appropriate security over Cabinet documents and other confidential departmental information.

6.314 In managing these business risks, disciplined governance arrangements and management practices are required over contract management and support services including human resources and financial management.

6.315 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is low to moderate. Key issues include:

- special accounts—government communications and advertising;
- accounting for special accounts, special programs and grants;
- contract management; and
- asset management.

6.316 The financial statement audit is focused on the material financial reporting risks flowing from the significant business risks, and the underlying business and accounting processes.

Corporate governance

6.317 Generally, a strong corporate governance regime imposes an alignment in the authority, responsibility and accountability within an entity. Aspects of the Department's corporate governance arrangements which impact on financial statement assurance include:

- an executive committee which oversights the operational performance of the various divisions; reviews departmental wide issues; and monitors financial performance;
- a monthly reporting regime against budget providing analysis of variations; and
- an audit committee which meets quarterly and focuses on the efficiency and effectiveness and probity of activities including risk assessment and management, internal audit planning and results, ANAO audit activities and fraud control.

6.318 The Department has developed a risk management plan. This will assist in strengthening the risk identification, assessment and prioritisation processes including the implementation or refinement of controls to minimise risk to an acceptable level.

Audit results

6.319 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised to date by the ANAO during the interim phase of the audit.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	1	1	0	0
Total	**1**	**1**	**0**	**0**

6.320 The results of the audit indicate that the Departmental systems and procedures have the capacity to produce accurate and complete information for financial reporting.

IT business processes

6.321 There were no Category A or B findings identified in the IT business processes in the prior year or this year.

IT security

6.322 There were no Category A or B findings identified for IT Security in the prior year or this year. A small number of Category C findings have been raised in the current year representing lower risk weaknesses in security controls.

Business continuity planning

6.323 An issue was raised in the prior year relating to the lack of a Department of Prime Minister and Cabinet Business Continuity Plan. The Department has moved to address this issue in the past year with the development of a Business Resumption Plan and is in the process of implementing the plan.

Financial reporting

6.324 The Department has a stable and efficient transactional financial reporting system. The Department reports against budget for the various programs and activities in both summary and detail form, and provides variance analysis as appropriate.

Conclusion

6.325 The Department has a sound control environment and has accepted ANAO findings. It has also agreed to implement ANAO recommendations aimed at further strengthening its controls and procedures.

Department of Transport and Regional Services

Business operations

6.326 The Department of Transport and Regional Services (the Department) is responsible for supporting the Government in achieving a better transport system for Australia, and greater recognition and opportunities for local, regional territory communities. It provides a range of transport and regional services to achieve this. As well, it conducts research, analysis and safety investigations; provides safety information and advice based on those investigations; and performs a range of regulatory functions. The Department is also responsible for the provision of services to Australia's external territories.

6.327 The Department's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$239 million; and
- administered appropriations—$3 277 million.

6.328 The Department's average staffing level for 2002–2003 is approximately 1115 staff across Australia.

Key business and financial statement risks

6.329 The Department's key risks are associated with the delivery of core programmes and in order to manage these, the Department addresses key issues relating to:

- the delivery of transport systems which are safer, more efficient, internationally competitive, sustainable and accessible;
- enabling regional communities to have better access to opportunities and services, and to lead in their own planning and development;
- assisting local governments to serve their communities more efficiently and effectively; and
- enabling residents of regional territories to have the same opportunities and responsibilities as other Australians enjoy in comparable communities.

6.330 To address these business risks, disciplined governance arrangements and management practices are required over program management activities, including compliance and regulatory issues. Integral to achieving this is adequate support services including management systems, IT, contract management, financial and sound human resource management.

6.331 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements, given the extent of resources managed by the Department, is at the medium level. Key issues for the current year include:

- materiality of the reclassification of Parking Infringement Notices (PINs) expenditure from departmental to administered; and
- application of AAS 26 'Financial Reporting of General Insurance Activities'.

6.332 The financial statement audit will focus on the material financial reporting issues flowing from the significant business risks and key processes including the above issues.

Corporate governance

6.333 Corporate governance arrangements in the Department which contribute to financial statement assurance include:

- fortnightly meetings attended by all members of the executive board which focuses on departmental-wide issues and monitors financial performance;
- an audit committee that meets at least quarterly and which focuses on risk management and strategic issues;
- a monthly financial reporting regime that includes variance analysis of financial results as compared to internal budgets and presentation of reports to divisions and the executive board;
- an internal audit plan which addresses compliance, business and financial risks; and
- an internal audit function which is independent and reports directly to the audit committee.

Audit results

6.334 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised to date by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	1	1	1	1
Total	**1**	**1**	**1**	**1**

General audit findings

Finance user access segregation

6.335 At the time of the audit a small number of user profiles were found to have access privileges in SAP in excess to those ANAO considers necessary to ensure adequate segregation of duties. This increases the risk that unauthorised modification may occur to transactions. These extended privileges have been periodically allowed in order to meet operational requirements within the small team, however, enforcement of a finance user access segregation matrix is an important control mechanism.

Financial reporting

6.336 The Department has a stable financial reporting process, which has been operating reliably for a significant period. The Department has continued with its policy of producing detailed monthly financial statements for management purposes along with variance analyses and relevant commentary. This process enables progressive assessment of financial performance.

Conclusion

6.337 The Department has strengthened its financial reporting and internal control structure. Management has been proactive in addressing the deficiencies identified in previous years.

Department of the Treasury

Business operations

6.338 The Department of the Treasury (the Department) is the primary advisory body to the Commonwealth Government on economic policy and development. Its mission is to improve the wellbeing of the Australian people, by providing sound and timely advice to the Government and assisting Treasury Ministers in the administration of their responsibilities and in the implementation of Government decisions. In accordance with this mission, the Treasury's advice is aimed at achieving the following three major policy outcomes:

- a sound macroeconomic environment;
- effective government spending and taxation arrangements; and
- well functioning markets.

6.339 In 2002–2003 the Department's administered funding includes Government revenues of $29.9 billion and $104.4 million for departmental running costs.

6.340 The Department's staffing level for 2002–2003 is approximately 709 (exclusive of the Royal Australian Mint). Staff levels increased from the prior financial year due to transfer of the taxation legislation design function from the Australian Taxation Office to the Department.

Key business and financial statement risks

6.341 In order to manage its key financial statement related business risks, the Department addresses key issues relating to:

- payment of grants to the States and Territories under the inter-governmental agreement;
- Commonwealth investments and the management of the Commonwealth's participation within the International Monetary Fund;
- the administration of the Commonwealth's HIH Claims Support Program;
- the administration of the Royal Australian Mint in the production of the Commonwealth's circulating coin; and
- FOREX management.

6.342 In managing these financial statement related business risks, disciplined management practices are required over the management of the Department's IT control environment and associated operating and accounting systems.

6.343 The ANAO assessment of the risk of material misstatements in the 2002–2003 financial statements is at the moderate level. Key issues for the current year include:

- financial statement preparation processes;
- financial and other regulatory requirements and their application;
- timing of information from consolidated entities;
- FMIS controls and management (including system upgrades);
- finalisation of the Chief Executive Instructions; and
- consolidation processes for business operations.

6.344 The financial statement audit will focus on the material financial reporting risks flowing from the significant financial statement related business risks and key business and accounting processes, including the above specific issues.

Corporate governance

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

- regular executive board meetings and direction on high level policy issues;
- a corporate plan which outlines strategic directions and is supported by operational plans that detail activities and performance targets;
- the support to the executive board by the audit committee. The committee provides a fundamental focus for the evaluation of the operations of the policies and procedures put in place by the secretary and the executive board and includes an independent member;
- preparation of monthly financial reports for review and analysis by the executive and general managers within each division; and
- an internal audit function and fraud control plan development and evaluation framework.

IT business processes

6.346 The Department is a significant user of IT to support its key business and financial reporting processes. Overall, the Department is aware of the need to maintain a well controlled computing environment and has several levels of management control to ensure this. In the current year, the ANAO has reviewed the IT general controls environment with a particular focus on the areas of information security, change management and business continuity management. This work has identified that there are adequate general controls to rely upon when determining our approach to auditing the financial statements.

Financial reporting

6.347 In the current year, the Department has further refined its financial reporting process. The Department produces monthly financial reports which are distributed to the members of the executive board and to managers of the business areas within each division. Key issues arising in the monthly reports are discussed at monthly executive board meetings. The reports currently include statements of financial position and financial performance, and a cash flow statement. Other reports produced focus on special purpose funding, outputs and outcomes, and staffing levels. Additionally, some analysis of budgeted versus actual results is provided.

Audit results

6.348 The following table provides a summary of the status of prior year issues and 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	0	0	0	0
B	4	4	1	1
Total	**4**	**4**	**1**	**1**

General audit findings

Asset management and recording

6.349 A number of issues surrounding the approval of asset disposals and the timeliness of the removal of assets from the asset register were noted. Asset management processes need to be strengthened and at present full reliance cannot be placed on the internal controls. The ANAO notes that the finance section has already instigated action to remedy the issues identified, and will review the progress of action prior to 30 June 2003.

Conclusion

6.350 The Department's management has responded positively to ANAO findings and the associated recommendations. The Department has already taken action to address aspects of the deficiencies identified by the ANAO.

Australian Taxation Office

Business operations

6.351 The Australian Taxation Office (ATO) is the Commonwealth's principal revenue collection agency. The ATO's role is to manage and shape taxation, excise and superannuation systems that give effect to the government's social and economic policy and fund services for Australians. The key business processes relate to revenue collection and compliance.

6.352 There have been significant changes to the business and operational environment within the ATO in recent years. This has stemmed from the level of tax system changes and assistance required by the taxpayers in order to understand and comply with the new tax obligations.

6.353 Over the past two years the ATO has responded to these challenges by initially deploying significant resources to taxpayer education and support, and error containment. The ATO is progressively rebalancing its support and enforcement activities with a managed shift of resources to active compliance. In addition considerable progress has been achieved in bedding down the new systems, managing the processing peaks and resolving the critical data integrity problems.

6.354 The ATO's appropriation funding for the year ending 30 June 2003 comprises:

- price of outputs—$2224 million;
- estimated administered revenue—$184 941 million; and
- administered expenses—$3439 million.

6.355 The ATO's average staffing level for 2002–2003 is 18 970 (FTE) across Australia.

Key business risks and financial statement risks

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

- tax administration covering policy and reform;
- self-management and voluntary compliance in collection and reporting of taxation revenues;
- complexity and dynamics of the IT environment in relation to developing and managing internal systems and on-line processing by taxpayers;

- workforce planning challenges balancing resources between public support, revenue collection and compliance activities; and
- maintaining community confidence.

6.357 The ANAO assessment of the risk of material misstatement in the 2002–2003 financial statements is **high**. Key issues for the current year include:

- fully supported reconciliations associated with the ATO business systems and FMIS;
- the ATO financial statement preparation process which is complex and uses data from a number of business systems;
- the ATO's progress on the management of provision for doubtful debts and credit amendments; and
- treatment of tax expenditures and tax offsets.

6.358 The financial statement audit will focus on the material financial reporting risks flowing from the significant business risks and key business and accounting processes including the above specific issues.

Corporate governance

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

- a strategic statement which provides an overview of the ATO directions for the future and includes corporate outcomes and performance measures. The statement is supported by four sub-plans namely Compliance, Operations, People and Place and Information Technology. The sub-plans are supported by tactical and business lines delivery plans;
- an executive board that meets at least monthly and has a formal biannual corporate governance process;
- a committee framework including an Audit Committee. The Audit Committee meets at least bi-monthly and focuses attention on risk assessment, fraud control and internal and external audit activities;
- a monthly financial reporting regime which provides actuals versus budget expenditure and revenue;

- an internal assurance branch that has a planned risk based coverage of the ATO's activities; and
- a fraud control plan.

Audit results

6.360 The following table provides a summary of the status of prior year issues as well as 2002–2003 audit issues raised by the ANAO.

Category	Issues outstanding as at March 2002	Issues resolved prior to March 2003	New issues to March 2003	Closing position as at March 2003
A	3	2	0	1
B	7	6	4	5
Total	**10**	**8**	**4**	**6**

General audit findings

Administered reconciliations ('A' category finding)

6.361 In prior years, the ANAO raised with the ATO serious concerns over the completion of key reconciliations between the FMIS and ATO business systems. These reconciliations are an important control to ensure the validity, accuracy and completeness of information contained in the business systems and general ledger. Progress has been made with the implementation of the reconciliation of the business systems to the general ledger. The major business system reconciliations have not been finalised since 30 June 2002. The minor business systems reconciliations have yet to be undertaken.

6.362 The ATO has acknowledged this concern and established processes to complete all the reconciliations by the end of the financial year and set up a strategy for regular and timely reconciliations.

Other findings

6.363 In addition, the audit highlighted the following issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements:

- billpay bank reconciliations—processes are required to ensure that there is a regular and complete reconciliation between the ATO and Australia Post records for revenue collection;
- certificate of compliance and related quality assurance—the certificate provides assurance that key processing controls are operating in relation to refunds. Issues have been identified in a number of areas surrounding

the scope of certificate of compliance and the integrity of the quality assurance processes;

- service level agreements—agreements need to be established or updated between the ATO and other organizations; and
- business continuity management (BCM)—the ATO is required to implement formally BCM policies and standards, complete testing of the BCMs and Disaster Recovery Plans, and develop, implement and test a Disaster Recovery Plan for their midrange computing platforms.

Financial reporting

6.364 The ATO management reporting process includes internal financial reports prepared for distribution and discussion at monthly executive meetings. These reports include an overall commentary, statements of financial position, financial performance and cash flows for departmental items. These internal reports also include analyses of actual expenditure compared to budgeted expectations.

6.365 For the administered position a formal report is prepared for the executive meeting at the end of each month related to revenue. This report is focused on cash collections. The majority of the report is an analysis of the actual position for the month compared to expectations.

Conclusion

6.366 Priority issues for resolution in 2002–2003 are in the area of reconciliations. The ATO has responded by taking or proposing appropriate steps to strengthen the respective controls and to implement a strategy to facilitate regular and timely completion of the reconciliations. These issues will be reviewed at the end of financial year audit.

7. Financial Aspects of the Conversion to Digital Broadcasting by the Australian Broadcasting Corporation (ABC)

This chapter presents the findings of an audit of the expenditure on Phase 1 conversion to digital broadcasting in the ABC. The audit was undertaken in response to a request from the Minister for Communications, Information Technology and the Arts for an assessment of the cost of Phase 1 of the conversion to digital broadcasting by the ABC.

Introduction

7.1 In January 2003, the Minister for Communications, Information Technology and the Arts wrote to the ANAO requesting an audit of the conversion to digital broadcasting by the ABC and Special Broadcasting Services (SBS). This included a request for an urgent assessment of the actual cost to the ABC of Phase 1 conversion to digital broadcasting.

7.2 The audit assessed the actual cost to the ABC of Phase 1 conversion to digital broadcasting and examined whether the costs incurred on Phase 1 digital conversion were consistent with the original submission and subsequent revisions as agreed with the Government. It covered total expenditure[40] incurred to 28 February 2003 by the ABC in relation to Phase 1. The audit did not extend to the physical sighting of the assets acquired or the technical aspects of digital engineering that specifically relate to Phase 1 digitisation.

7.3 The Auditor-General Audit Report No.11 of 1999–2000, *Financial Aspects of the Conversion to Digital Broadcasting* outlined the progress made by the ABC and SBS towards preparation for digital broadcasting. That Report, which was prepared in response to a request from the then Minister for Communications for an assessment of the cost of Phase 1 digital conversion, described the introduction of digital broadcasting in the following terms.

> The introduction of digital broadcasting marks a significant shift in communications technology away from the analogue system, which has been used in Australia from the first days of radio 75 years ago and since television broadcasting began in 1956. The new technology will offer the possibility of a

40 Total expenditure includes actual costs, committed costs (ABC has an obligation to pay on receipt of goods and services) and estimated costs to complete for Phase 1. 'Cost' does not include any apportionment of internal overheads or employee costs involved in the management and administration of digital projects. The forecast cost to complete has been provided by the ABC.

wider range of services, including high definition television, multi-channelling (for both radio and television) and data transmission. For broadcasters and their audiences the introduction of this new technology transforms the broadcasting environment, bringing new opportunities and also new costs.

7.4 The ABC developed a staged approach for the conversion of its analogue facilities to digital technology, at the centre of which was a five-year digital conversion strategy for Phase 1. This strategy was provided to the Government in November 1997. During this first phase the ABC was to purchase digital production equipment, convert its existing analogue radio and television studios; convert its archive material; and enhance its regional services. This was to involve enhancing the capacity of existing ABC regional stations to produce local programs and to feed material back into the capital cities for inclusion in national and state-wide programming.

7.5 In accordance with the requirements of the *Television Broadcasting Services (Digital Conversion) Act 1998* and *Datacasting Charge (Imposition) Act 1998*, Digital Terrestrial Television Broadcasting (DTTB) has been broadcast in metropolitan areas from 1 January 2001 and will be broadcast in regional areas over the following three years. This will enable all of Australia to have access to DTTB by 1 January 2004.

7.6 Audit Report No.11 of 1999–2000 also stated that:

> In April 1998, the government agreed to provide $20 million over five years (indexed to $20.8 million) to assist the ABC with off-Budget borrowings and $16.9 million over five years to the SBS (indexed to $17.7 million), towards the costs that both broadcasters would incur in implementing Phase 1 of their respective strategies. The government also agreed to give further consideration to the need for additional funding after two years when greater certainty would exist about the proceeds from property rationalisations and the costs of subsequent phases.

7.7 In October 1998, the Government advised the ABC that the Commonwealth would cover the outstanding debt in relation to Phase 1 of the ABC's digital conversion plans at the end of 2002–2003.

7.8 In June 1999, the ABC estimated that the cost of Phase 1 conversion would be $119 million comprising $110 million in capital costs and a further $9 million interest on borrowings.

Audit findings

Estimated total cost of Phase 1

7.9 In June 1999, the estimated total cost of Phase l was $110.0 million (plus a component of $9 million covering interest for borrowings). In December 2002, the estimated total cost for Phase 1 had risen to $147.7 million (including interest of $9.9 million). The ABC Board approved the allocation of $27.8 million for additional expenditure from future ABC capital allocations for Phase 1 digital conversion for future acquisitions of digital equipment in order to fully complete the project.

Figure 7.1

Summary of the movement in the estimated total cost of Phase 1

	June 1999 submission	February 2003 actual	Outstanding commitments as at February 2003	Estimate to complete	Estimated total expenditure as at October 2004
Radio	11.9	16.7		3.3	20.0
Television	73.6	89.3	5.4	3.1	97.8
IT and Infrastructure	12.5	7.2		0.8	8.0
Archives	10.9	0.2		10.7	10.9
Training	1.1	0.8		0.3	1.1
Sub-Total	110.0	114.2	5.4	18.2	137.8
Interest	9.0	7.5		2.4	9.9
Totals	**119.0**	**121.7**	**5.4**	**20.6**	**147.7**

Source: ABC

7.10 ABC papers indicate that the additional expenditure of $27.8 million would allow the ABC to complete the digital conversion of Phase 1 to a level of functionality currently established in the planning and implementation including the digitisation of archived analogue and video material identified in the funding submission. It would also cover financial commitments entered into for the delivery of equipment. The ABC identified the reasons for the increase in the cost of conversion as being:

- the ABC's estimates of cost of conversion including Phase 1, reflected the minimum reasonable costs of conversion;
- prices included in the original ABC submission for funding for Phase 1 digitisation were best estimates of products that had not been catalogued in the market at the time of the submission; and
- the scope of the digital Phase 1 conversion program for the ABC could not be fully assessed relative to the emerging technologies relating to digital broadcasting in 1997–1998.

7.11 Audit Report No.11 of 1999–2000 suggested that some improvement was needed to ensure adequate information, in the form of detailed descriptions, was recorded in the ABC's financial records. This would ensure that the ABC had accurate and detailed records relative to the expenditure on Phase 1. This audit revealed that adequate information was available in the ABC's financial records which provided sufficient detail to trace expenditure to source documentation.

Audit conclusion

7.12 The ANAO concluded that the ABC has spent $121.7 million, including interest, as at 28 February 2003, and had outstanding commitments of $5.4 million on Phase 1 digital conversion. The ABC has forecast an additional $20.6 million, including interest, to complete Phase 1, bringing the estimated total cost to $147.7 million.

Appendices

Appendix 1

Significant Findings by Major Entity

The following table sets out ‘A’ rated findings (significant business or financial risks) identified during the interim audit of entities as part of the 2002-2003 financial statement audit cycle.

Table 1

Summary of ‘A’ category findings

Entity	No of ‘A’ findings	Explanatory Comment
Department of Defence	10	Six of the Category A findings are carried forward from the previous year. There are issues in asset management including inventory pricing and consumption, in conjunction with asset recognition and write-downs and specialist military equipment repairs. In addition concerns exist with personnel records administration and system processes.
Australian Taxation Office (ATO)	1	The administered cash reconciliations and reconciliations of supporting business systems to the FMIS are key controls over the accuracy and validity of the financial information. A number of deficiencies have been noted relating to the completion and significant progress has been made to date of these critical reconciliations. The ATO has responded by implementing a project to address the completion of these reconciliations. Significant exposure to the risk of mainframe inoperability exists, which is not adequately addressed in the business resumption plan or disaster recovery plan.

Further details on each of these findings, and on the ‘B’ rating findings, are included in the individual entity summaries contained in Chapter 6 of this report. A table summarising the number of ‘A’ and ‘B’ findings follows.

Table 2

'A' and' 'B' ratings by entity

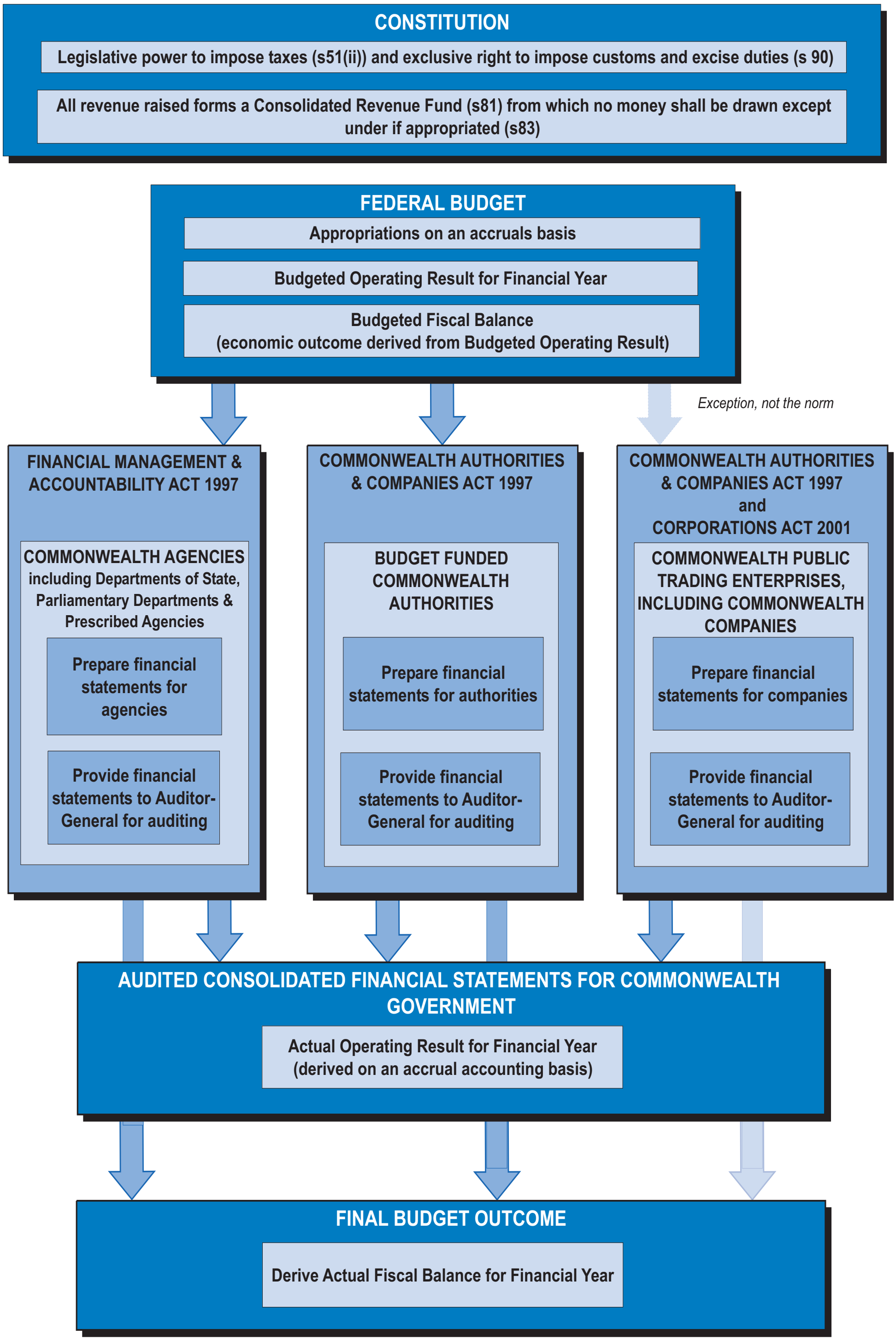
Entity	2003 Rating		2002 Rating	
	A	B	A	B
Department of Agriculture, Fisheries and Forestry—Australia	0	4	0	1
Attorney-General's Department	0	1	0	4
Australian Customs Service	0	2	0	2
Department of Communications, Information Technology and the Arts	0	7	0	8
Department of Defence	10	29	13	32
Repatriation Commission and the Department of Veterans' Affairs	0	4	0	0
Department of Education, Science and Training	0	2	0	3
Department of Employment and Workplace Relations	0	5	0	8
Department of the Environment and Heritage	0	2	1	3
Department of Family and Community Services	0	6	0	4
Centrelink	0	5	0	3
Department of Finance and Administration	0	0	0	0
Department of Foreign Affairs and Trade	0	1	0	1
Department of Health and Ageing	0	5	0	5
Health Insurance Commission	0	7	1	12
Department of Immigration and Multicultural and Indigenous Affairs	0	6	0	14
Department of Industry, Tourism and Resources	0	3	0	3
Department of the Prime Minister and Cabinet	0	0	0	1
Department of Transport and Regional Services	0	1	0	1
Department of the Treasury	0	1	0	4
Australian Taxation Office	1	5	3	7
Total	**11**	**96**	**18**	**116**

Appendix 2

The Commonwealth Government Financial Reporting Framework

Framework overview

The Commonwealth Government's financial reporting framework is outlined in the diagram below. Then follows an overview of the financial reporting requirements for the various types of Commonwealth entities captured by the framework. Finally the audit of the financial statements of these entities is described.


CONSTITUTION
Legislative power to impose taxes (s51(ii)) and exclusive right to impose customs and excise duties (s 90)
All revenue raised forms a Consolidated Revenue Fund (s81) from which no money shall be drawn except under if appropriated (s83)
FEDERAL BUDGET
Appropriations on an accruals basis
Budgeted Operating Result for Financial Year
Budgeted Fiscal Balance (economic outcome derived from Budgeted Operating Result)
Exception, not the norm
FINANCIAL MANAGEMENT & ACCOUNTABILITY ACT 1997
COMMONWEALTH AGENCIES including Departments of State, Parliamentary Departments & Prescribed Agencies
Prepare financial statements for agencies
Provide financial statements to Auditor-General for auditing
COMMONWEALTH AUTHORITIES & COMPANIES ACT 1997
BUDGET FUNDED COMMONWEALTH AUTHORITIES
Prepare financial statements for authorities
Provide financial statements to Auditor-General for auditing
COMMONWEALTH AUTHORITIES & COMPANIES ACT 1997 and CORPORATIONS ACT 2001
COMMONWEALTH PUBLIC TRADING ENTERPRISES, INCLUDING COMMONWEALTH COMPANIES
Prepare financial statements for companies
Provide financial statements to Auditor-General for auditing
AUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR COMMONWEALTH GOVERNMENT
Actual Operating Result for Financial Year (derived on an accrual accounting basis)
FINAL BUDGET OUTCOME
Derive Actual Fiscal Balance for Financial Year

Commonwealth Government of Australia

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

The financial statements for the year ended 30 June 2002 and the audit report thereon were published in November 2002.[41] The results of the audit were reported to Parliament in the ANAO Report No.25 2002–2003, *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002*.

Commonwealth agencies

Commonwealth agencies are legally part of the Commonwealth Government and are subject to the provisions of FMA Act. They comprise departments of State, Parliamentary departments and prescribed agencies.

The FMA Act requires agency Chief Executives to prepare financial statements for their agencies in accordance with Finance Minister's Orders (FMOs). The FMOs include a requirement that the statements comply with accounting standards issued by the Australian Accounting Standards Board.

Commonwealth authorities and subsidiaries

Commonwealth authorities are bodies corporate that hold money on their own account and have been created by the Parliament to perform specific functions. Authorities operate under their own enabling legislation and generally must comply with provisions of the *Commonwealth Authorities and Companies Act 1997* (CAC Act).

The CAC Act requires the governing bodies of authorities to prepare financial statements in accordance with the FMOs. Directors must also ensure that subsidiaries prepare financial statements in accordance with the *Corporations Act 2001* (where applicable) and the CAC Act.

Commonwealth companies and subsidiaries

Commonwealth companies are companies in which the Commonwealth has a controlling interest. Commonwealth companies operate and prepare financial statements under the *Corporations Act 2001* and provisions of the CAC Act.

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41 Commonwealth Government of Australia, Consolidated Financial Statements for the Year Ended 30 June 2002, Canberra, November 2002.

Directors of a Commonwealth company must ensure subsidiaries of the company prepare financial statements in accordance with the *Corporations Act 2001* and the CAC Act.

Other bodies

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

Audit of Commonwealth Government financial statements

Audit scope

The Chief Executives of agencies, and the directors of authorities and companies, are responsible for the truth and fairness of the financial statements and for the records, controls, procedures and organisation that support the preparation of those statements.

The ANAO's independent audits of financial statements are undertaken to form an opinion whether, in all material respects, the statements are true and fair. The audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards (AUS), to provide reasonable assurance as to whether the financial statements are free of material misstatement.

Audit procedures include examination of the entity's records and its control environment, information systems, control procedures and statutory disclosure requirements. Evidence supporting the amounts and other information in the statements is examined on a test basis, and accounting policies and significant accounting estimates are evaluated.

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

The primary responsibility for the prevention and detection of fraud and error rests with both those charged with the governance and the management of an entity. An audit conducted in accordance with AUS is designed to provide reasonable assurance that the financial report, taken as a whole, is free from material misstatement, whether caused by fraud or error. The fact that an audit is carried out may act as a deterrent. However, the auditor is not responsible for the prevention of fraud and error.

The audit report on financial statements

The audit report on the financial statements includes a statement of the auditor's opinion as to whether the statements give a true and fair view of the entity's financial position, the results of its financial operations and its cash flows in accordance with Australian Accounting Standards, and other mandatory professional reporting requirements, and statutory requirements.

If the auditor is not satisfied the financial statements are true and fair, the audit opinion is qualified, with the reasons being indicated. Audit reports may be qualified because of a disagreement between the auditor and management of the entity on the application of accounting standards or other reporting requirements, because the scope of the audit work needed to form an opinion has been limited in some way, or because of a conflict between applicable reporting requirements.

An audit report may contain an 'emphasis of matter' to draw attention to a matter that is relevant to the readers of the financial statements. An 'emphasis of matter' does not qualify the audit opinion being given. In many cases, an 'emphasis of matter' relates to inherent uncertainty about an aspect of the financial statements, where the outcome is contingent upon future events and the effects of the matter are not capable of reasonable measurement at the date the audit report is signed.

Canberra ACT
30 June 2003

P.J. Barrett
Auditor-General

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