

The Auditor-General  
Audit Report No.49 2012–13  
Financial Statement Audit

**Interim Phase of the Audits of the Financial  
Statements of Major General Government  
Sector Agencies for the year ending  
30 June 2013**

Australian National Audit Office

© Commonwealth of Australia 2013

ISSN 1036-7632

ISBN 0 642 81368 X (Print)

ISBN 0 642 81369 8 (On-line)

Except for the content in this document supplied by third parties, the Australian National Audit Office logo, the Commonwealth Coat of Arms, and any material protected by a trade mark, this document is licensed by the Australian National Audit Office for use under the terms of a Creative Commons Attribution-NonCommercial-NoDerivatives 3.0 Australia licence. To view a copy of this licence, visit

<http://creativecommons.org/licenses/by-nc-nd/3.0/au/>

You are free to copy and communicate the document in its current form for non-commercial purposes, as long as you attribute the document to the Australian National Audit Office and abide by the other licence terms. You may not alter or adapt the work in any way.

Permission to use material for which the copyright is owned by a third party must be sought from the relevant copyright owner. As far as practicable, such material will be clearly labelled.

For terms of use of the Commonwealth Coat of Arms, visit It's an Honour at <http://www.itsanhonour.gov.au/coat-arms/index.cfm>.

Requests and inquiries concerning reproduction and rights should be addressed to:

Executive Director  
Corporate Management Branch  
Australian National Audit Office  
19 National Circuit  
BARTON ACT 2600

Or via email:

[webmaster@anao.gov.au](mailto:webmaster@anao.gov.au)





Canberra ACT  
20 June 2013

Dear Mr President  
Dear Madam Speaker

The Australian National Audit Office has undertaken the interim audit phase of the 2012–13 financial statements audits of major General Government Sector agencies in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of these audits to the Parliament. The report is titled *Interim Phase of the Audits of the Financial Statements of Major General Government Sector Agencies for the year ending 30 June 2013*.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

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

For further information contact:

**The Publications Manager**  
**Australian National Audit Office**  
**GPO Box 707**  
**Canberra ACT 2601**

**Telephone:** (02) 6203 7505

**Fax:** (02) 6203 7519

**Email:** [webmaster@anao.gov.au](mailto:webmaster@anao.gov.au)

ANAO audit reports and information about the ANAO are available at our internet address:

<http://www.anao.gov.au>

# Contents

Abbreviations and Acronyms .....	9
Summary .....	12
Introduction .....	12
Developments in financial reporting and auditing frameworks .....	13
Summary of audit results .....	14
Future audit coverage .....	17
1. Introduction .....	18
Background .....	18
Report structure .....	19
Acknowledgements .....	20
2. Financial Reporting and Auditing Frameworks .....	21
Introduction .....	21
Recent changes to the Australian public sector reporting framework .....	22
Future developments in the Australian public sector reporting framework.....	24
International projects.....	26
Developments in auditing standards.....	30
Conclusion .....	33
3. Summary of Audit Findings and Related Issues .....	35
Introduction .....	35
Internal control .....	37
Control environment.....	37
Agency risk assessment process.....	42
Information system.....	44
Control activities.....	44
Monitoring of controls.....	56
Conclusion .....	58
4. Information Technology Controls .....	59
Introduction .....	59
IT control environment .....	60
General IT controls.....	62
Application controls.....	65
Trends over the period 2009–10 to 2012–13.....	71
Major technology change activities .....	76
Data centre strategy.....	77
Legacy systems .....	79
Conclusion .....	81

5. Results of the Interim Audit Phase by Agency.....	83
Introduction .....	83
Agriculture, Fisheries and Forestry Portfolio.....	86
Department of Agriculture, Fisheries and Forestry .....	86
Attorney-General's Portfolio .....	91
Attorney-General's Department .....	91
Australian Customs and Border Protection Service.....	95
Broadband, Communications and the Digital Economy Portfolio .....	103
Department of Broadband, Communications and the Digital Economy .....	103
Defence Portfolio.....	108
Department of Defence .....	108
Defence Materiel Organisation .....	119
Department of Veterans' Affairs.....	126
Education, Employment and Workplace Relations Portfolio.....	134
Department of Education, Employment and Workplace Relations.....	134
Families, Housing, Community Services and Indigenous Affairs Portfolio .....	140
Department of Families, Housing, Community Services and Indigenous Affairs .....	140
Finance and Deregulation Portfolio.....	146
Department of Finance and Deregulation.....	146
The Board of Guardians and the Future Fund Management Agency.....	151
Foreign Affairs and Trade Portfolio .....	155
Department of Foreign Affairs and Trade .....	155
Health and Ageing Portfolio .....	159
Department of Health and Ageing.....	159
Human Services Portfolio.....	165
Department of Human Services.....	165
Immigration and Citizenship Portfolio.....	172
Department of Immigration and Citizenship.....	172
Industry, Innovation, Climate Change, Science, Research and Tertiary Education Portfolio .....	177
Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education.....	177
Infrastructure and Transport Portfolio .....	183
Department of Infrastructure and Transport .....	183
Prime Minister and Cabinet Portfolio.....	188
Department of the Prime Minister and Cabinet.....	188
Regional Australia, Local Government, Arts and Sport Portfolio .....	192
Department of Regional Australia, Local Government, Arts and Sport .....	192
Resources, Energy and Tourism Portfolio .....	196
Department of Resources, Energy and Tourism .....	196

Sustainability, Environment, Water, Population and Communities Portfolio .....	200
Department of Sustainability, Environment, Water, Population and Communities .....	200
Treasury Portfolio .....	204
Department of the Treasury .....	204
Australian Office of Financial Management .....	209
Australian Taxation Office .....	212
<b>Appendices .....</b>	<b>219</b>
Appendix 1: Agencies covered by this report .....	221
Appendix 2: The Accounting and Auditing Standards Frameworks .....	222
Appendix 3: The Financial Reporting Framework .....	223
Series Titles .....	229
Current Better Practice Guides .....	235

## Tables

Table 4.1	Elements of the IT control environment.....	61
Table 5.1	Significant and moderate findings of agencies grouped by portfolio, reported at completion of the 2011–12 and 2012–13 interim audit phases .....	85

## Figures

Figure 3.1	Aggregate audit findings – categories A, B and C .....	46
Figure 3.2	IT control environment – aggregate audit findings .....	47
Figure 3.3	Purchases and payables – aggregate audit findings .....	48
Figure 3.4	Grant accounting – aggregate audit findings.....	49
Figure 3.5	Accounting and control of non-financial assets – aggregate audit findings .....	51
Figure 3.6	Revenue, receivables and cash management – aggregate audit findings .....	52
Figure 3.7	Human resource management process – aggregate audit findings .....	54
Figure 3.8	Other control matters – aggregate audit findings .....	55
Figure 4.1	2012–13 Assessment of IT security management .....	63
Figure 4.2	2012–13 Assessment of IT change management.....	65
Figure 4.3	Summary of FMIS applications 2009–10 to 2012–13 .....	66
Figure 4.4	Summary of HRMIS applications 2009–10 to 2012–13 .....	66
Figure 4.5	2012–13 assessment of FMIS controls .....	68
Figure 4.6	2012–13 assessment of HRMIS controls .....	70
Figure 4.7	IT security governance: 2009–10 to 2012–13.....	72

Figure 4.8	Change management policy and governance frameworks: 2009–10 to 2012–13.....	72
Figure 4.9	FMIS privileged user management: 2009–10 to 2012–13 .....	73
Figure 4.10	FMIS business continuity: 2009–10 to 2012–13 .....	74
Figure 4.11	HRMIS privileged user management: 2009–10 to 2012–13 .....	75
Figure 4.12	HRMIS business continuity: 2009–10 to 2012–13 .....	76
Figure 4.13	Data centre strategy and data centre optimisation targets policy – progress achieved .....	78
Figure 4.14	Agencies’ legacy systems .....	80



# Abbreviations and Acronyms

---

AAO	Administrative Arrangements Order
AAS	Australian Accounting Standard
AASB	Australian Accounting Standards Board
AGD	Attorney-General's Department
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
ASA	Australian Auditing Standards
ATO	Australian Taxation Office
AUASB	Australian Auditing and Assurance Standards Board
BCM	Business Continuity Management
BCP	Business Continuity Plan
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CEIs	Chief Executive's Instructions
CE	Chief Executive
CFO	Chief Finance Officer
CFS	Consolidated Financial Statements
CoC	Certificate of Compliance
Customs and Border Protection	Australian Customs and Border Protection Service
DMO	Defence Materiel Organisation

DAFF	Department of Agriculture, Fisheries and Forestry
DBCDE	Department of Broadband, Communications and the Digital Economy
Defence	Department of Defence
DEEWR	Department of Education, Employment and Workplace Relations
DFAT	Department of Foreign Affairs and Trade
DIAC	Department of Immigration and Citizenship
DI&T	Department of Infrastructure and Transport
DIICCSRTE	Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education
DoHA	Department of Health and Ageing
DHS	Department of Human Services
DRET	Department of Resources, Energy and Tourism
DSEWPAC	Department of Sustainability, Environment, Water, Population and Communities
DVA	Department of Veterans' Affairs
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
FASB	United States Financial Accounting Standards Board
Finance	Department of Finance and Deregulation
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMIS	Financial Management Information System
FMOs	Finance Minister's Orders
FRSB	New Zealand Financial Reporting Standards Board
GAAP	Generally Accepted Accounting Principles

GFS	Government Finance Statistics
GGG	General Government Sector
HRMIS	Human Resources Management Information System
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IPSASB	International Public Sector Accounting Standards Board
ISA	International Standards on Auditing
IT	Information Technology
JCPAA	Joint Committee of Public Accounts and Audit
PM&C	Department of the Prime Minister and Cabinet
RBA	Reserve Bank of Australia
Treasury	Department of the Treasury

# Summary

---

## Introduction

1. The *Auditor-General Act 1997* establishes the mandate for the Auditor-General to undertake financial statement audits of all Australian Government entities including those of Government agencies, statutory authorities and Government business enterprises.

2. The preparation of audited financial statements in compliance with the Finance Minister's Orders<sup>1</sup> is a key element of the financial management and accountability regime applicable to Australian Government entities. It is generally accepted in both the private and public sectors that a good indicator of the effectiveness of an entity's financial management is the timely finalisation of its annual financial statements, accompanied by an unmodified audit opinion. Australian Government entities, in cooperation with the Australian National Audit Office (ANAO), devote considerable effort to achieving such an outcome.

3. Financial statement audits are an independent examination of the financial accounting and reporting of public sector entities. The results of the examination are presented in an auditor's report, which expresses the auditor's opinion on whether the financial statements as a whole and the information contained therein fairly present each entity's financial position and the results of its operations and cash flows. The accounting treatments and disclosures reflected in the financial statements by the entity are assessed against relevant accounting standards and legislative reporting requirements.

4. Under section 57 of the *Financial Management and Accountability Act 1997* (FMA Act), the Auditor-General is required to report each year to the relevant Minister on whether the financial statements of agencies<sup>2</sup> 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.

5. To assist agencies to manage their responsibilities, the ANAO periodically publishes better practice guides on a range of aspects of public

---

<sup>1</sup> The Finance Minister's Orders (FMOs) made by the Minister for Finance and Deregulation set out the requirements for the preparation of financial statements of all reporting entities covered by the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.

<sup>2</sup> The term 'agencies' refers to all organisations subject to the *Financial Management and Accountability Act 1997* (FMA Act). As the organisations covered by this report are 'agencies', this term is used predominantly in the report.

administration. During 2012–13, the ANAO published three Better Practice Guides: *Public Sector Internal Audit*; *Preparation of Financial Statements by Public Sector Entities*; and *Human Resource Management Information Systems: Risks and Controls*. Better Practice Guides are well received by agencies and contribute to agencies maintaining the maturity of their internal control systems and enhancing their performance.

6. The interim phase of the audit of agencies encompasses a review of governance arrangements related to agencies' financial reporting responsibilities, and an examination of relevant internal controls, including information technology system controls. The ANAO's examination of these areas is designed to assess the reliance that can be placed on agencies' internal controls to produce complete and accurate information for financial reporting purposes.

7. The audit findings in this report have been reported to the management of each agency and to the responsible Minister(s).

## Developments in financial reporting and auditing frameworks

8. The Australian Accounting Standards Board (AASB) has continued to work towards improved financial reporting by adding to or modifying Australian Accounting Standards. In 2012–13, the AASB issued guidance on accounting for carbon tax, a new standard requiring government entities to report their performance against budget, and proposals to require public sector entities to disclose in their financial statements executive remuneration and other related party transactions, in line with existing standards for the private sector.

9. The International Public Sector Accounting Standards Board is developing a conceptual framework that will shape the future of its accounting standards for the public sector. Other significant international projects are also well underway, potentially changing reporting requirements in important areas such as financial instruments, revenue and leases. In the future, many changes to Australian Accounting Standards will be driven by developments internationally.

10. During 2012–13 the Australian Auditing and Assurance Standards Board released a guidance statement to assist in the application of standards to greenhouse and energy schemes and programs and issued an exposure draft of

a proposed standard *Assurance Engagements on General Purpose Water Accounting Reports* designed to improve the quality of water accounting reports. The Board also released a policy on the harmonisation of Australian and New Zealand auditing standards.

11. Internationally, a top priority of the International Auditing and Assurance Standards Board is a project on auditor reporting that aims to enhance the relevance and usefulness of auditor's reports to stakeholders.

## Summary of audit results

### Internal control in agencies<sup>3</sup>

12. A central element of the ANAO's financial statement audit methodology, and the focus of the interim phase of ANAO audits, is a sound understanding of an agency's responsibilities and internal controls to inform our audit approach including the reliance we may place on agency systems to produce financial statements that are free from material misstatement. To do this, the ANAO uses the framework contained in the ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*. The key elements of internal control, as discussed in ASA 315, are the control environment; the risk assessment process; the information system, including the related business processes relevant to financial reporting and communication; control activities; and monitoring of controls.

### Control environment

13. The ANAO assesses whether an agency's control environment includes measures that contribute positively to sound corporate governance in the context of the preparation of an agency's financial statements. These measures should be designed to mitigate identified risks of material misstatement in the financial statements, and reflect the specific governance requirements of each agency.

14. The ANAO observed that agencies have in place key elements of a financial control environment designed to provide a sound basis for the effective preparation of the agency's financial statements. Audit committees, in particular, continue to have a positive influence on the effectiveness of

---

<sup>3</sup> The term 'agencies' refers to the 24 major General Government Sector agencies referred to in this report. These are listed at appendix 1.

agencies' control environments particularly in the areas of risk assessment, legislative compliance and financial system controls.

### **Risk assessment process**

15. An understanding of an agency's risk assessment processes is an essential element of the ANAO's financial statement audits. Agencies are expected to manage the key risks specific to their environment and the interim audit phase includes a review of controls relating to risks that may have a material impact on agencies' financial statements. Generally, the ANAO found that agencies have established formal risk assessment processes, overseen by audit committees or other committees with specific risk management responsibilities.

16. An important element of the risk assessment process common to all agencies is fraud control management. Most agencies have fraud control plans prepared in accordance with the Commonwealth Fraud Control Guidelines and have formal processes for updating these plans.

### **Information system**

17. Information technology facilitates the way in which Australian Government agencies operate, and supports the business processes that deliver services to the Australian community.

18. Consistent with past practice, during the 2012–13 interim audits, the ANAO assessed the design and operation of key IT controls to determine the effectiveness of these controls and their impact on reducing risks affecting the integrity of financial information presented in agencies' financial statements.

19. Following a general improvement in IT controls in 2011–11 and 2011–12, in 2012–13 there was an increase in the number of agencies where improvements were warranted in a number of IT controls. These included management of FMIS and HRMIS privileged user access, change management policy and governance, FMIS and HRMIS business continuity management, and aspects of IT security management.

### **Control activities**

20. The results of the 2012–13 interim audit phase indicated that, overall, control activities relating to financial and accounting processes have continued to be maintained at an effective level. The total number of significant and moderate audit findings has decreased, continuing the trend over recent years.

Control issues identified by the audits related to areas such as: IT general and application controls, particularly the management of user access to key financial business systems and accounting for non-financial assets, including the capitalisation and disposal of assets. A total of 124 category A, B, C and L1 findings<sup>4</sup> were identified in the 2012–13 interim audit phase, with the majority of these findings posing a low business or financial management risk, a reduction compared with the 146 findings identified in 2011–12.

## **Monitoring of controls**

21. Many activities undertaken by agencies contribute to their regime of monitoring controls. These include quality assurance arrangements, internal and external reviews, control self-assessment processes, and internal audit. In particular, all agencies have in place arrangements to enable Chief Executives to provide an annual Certificate of Compliance<sup>5</sup>.

22. The ANAO continues to include an assessment of compliance in relation to annual appropriations, special appropriations, special accounts and the investment of public moneys in its financial statement audits as a result of interest shown by the Joint Committee of Public Accounts and Audit in past years. The 2012–13 interim phase audits continued to identify a high level of compliance in these areas, although actual or potential breaches of section 83 of the Constitution<sup>6</sup> continue to be identified by a number of agencies. The incidence of these actual or potential breaches has reduced significantly mainly as a result of legislative amendments to relevant legislation in late 2011–12 and during 2012–13. This matter is discussed at paragraphs 3.26 to 3.29 of chapter 3 of this report.

## **Agency audit findings**

23. The results of the 2012–13 interim audits reflect a continuation of the reduction over recent years in the number of significant (category A) and moderate (category B) audit findings. This reflects the general stability and

---

<sup>4</sup> The ANAO rates its audit findings according to a risk scale. Audit findings that pose a significant business or financial management risk to the entity are rated as 'A'. Findings that pose a moderate business or financial management risk are rated as 'B'. Findings that pose a low business or financial management risk are rated as 'C'. Category L1 findings are instances of potential non-compliance with the Constitution or non-compliance with key legislative requirements.

<sup>5</sup> Agency Chief Executives are required to certify on an annual basis their agency's compliance with components of the Government's financial management framework. Further details of this process are outlined at paragraphs 3.23 and 3.24 of chapter 3 of this report.

<sup>6</sup> Section 83 of the Constitution provides that expenditure by the Commonwealth must be in accordance with appropriations made by the Parliament.



maturity of the control regimes in the majority of agencies and actions taken by agencies to address prior year audit findings.

24. However, as noted above, audits continue to identify control weaknesses in a number of areas such as: IT general and application controls, particularly the management of user access to key financial business systems and accounting for non-financial assets, including the capitalisation and disposal of assets.

25. Generally, agencies have been positive and timely in their response to ANAO audit findings.

26. The following is a summary of the trend in category A, B and L1 audit findings between 2011–12 and 2012–13 reported at the completion of the interim audit phase. There were:

- no category A findings reported in 2012–13. This was a reduction from one reported in 2011–12;
- twenty-three category B audit findings across agencies in 2012–13. This is an improvement from 31 findings reported in 2011–12;
- increases in the number of category B audit findings in three agencies; five showed a decrease; three remained constant; and 13 agencies had no category B findings in either 2011–12 or 2012–13; and
- eleven category L1 findings reported in 2012–13 compared to one in 2011–12.

27. A summary of category A, B and L1 audit findings by agency is provided in table 5.1 in chapter 5.

## Future audit coverage

28. In completing the audits of agencies' 2012–13 financial statements, the ANAO will complete its assessment of the effectiveness of internal controls and areas of audit focus in each agency. The summary results of this work will be reported by the ANAO in December 2013.

# 1. Introduction

---

*This chapter provides background to the audits of the financial statements of Australian Government entities and sets out the structure of this report that covers 24 major General Government Sector agencies.*

## Background

**1.1** In addition to undertaking financial statement audits of individual entities, the ANAO tables two reports annually that summarise the findings of the financial statement audits of public sector entities. These reports also discuss contemporary issues and practices affecting public sector entities' financial reporting responsibilities and the ANAO's responsibilities. This report outlines the ANAO's assessment of the internal controls of major agencies, including governance arrangements, information systems and control procedures. The findings summarised in this report are the results of the interim phase<sup>7</sup> of the financial statement audits of 24 major General Government Sector agencies that represent some 95 per cent of total General Government Sector<sup>8</sup> (GGS) revenues and expenses.

**1.2** In reporting on the results of the interim phase of the financial statement audit program, the ANAO is providing assurance to the Parliament that the systems, controls and processes that are in place in major Australian Government agencies are operating in a way that allows agencies to prepare financial statements that give a true and fair view of their financial performance and position at financial year end.

**1.3** The audit coverage undertaken forms an integral part of the ANAO's audit of the 2012–13 financial statements of these agencies. This report includes reference to issues that have the potential to have a material impact on agencies' financial statements and to other control related matters requiring attention by agency management.

---

<sup>7</sup> Financial statement audits are generally performed in two phases—interim and final. The interim phase focuses on an assessment of agencies' key internal controls; in the final audit phase the ANAO completes its assessment of the effectiveness of key controls for the full year, substantively tests material balances and disclosures in the financial statements, and finalises its opinion on the agencies' financial statements.

<sup>8</sup> The General Government Sector (GGS) comprises all government agencies and other entities that provide largely non-market public services and are funded primarily through taxes. This report covers the portfolio departments and other major GGS entities that comprise approximately 95 per cent of total GGS revenues and expenses. The number of agencies reflects the Administrative Arrangements Order of 25 March 2013 that involved the abolition of the Department of Climate Change and Energy Efficiency.

**1.4** At the individual agency level, a report on the results of the audit is provided to each agency Chief Executive and audit committee. Audit activity can act as a catalyst for improvement and provide a stimulus to agency management for the resolution of issues, where this is warranted.

**1.5** The preparation of financial statements in compliance with the Finance Minister's Orders<sup>9</sup> is a key element of the financial management and accountability regime applicable to Australian Government entities. It is generally accepted in both the private and public sectors that a good indicator of the effectiveness of an entity's financial management is the timely finalisation of its annual financial statements, accompanied by an unmodified audit opinion. Australian Government entities, in cooperation with the ANAO, devote considerable effort to achieving timeliness in financial reporting.

## Report structure

**1.6** The report is organised as follows:

- Chapter 2 discusses a number of recent developments in accounting and auditing requirements and, in doing so, provides an overview of changes impacting the Australian Government's reporting and accountability frameworks.
- Chapter 3 provides summary observations relating to various elements of agencies' internal controls (including the control environment, the risk assessment process, the information system, control activities and monitoring of controls). This chapter also includes a discussion of audit findings over the period 2009–10 to 2012–13.
- Chapter 4 outlines findings relating to the audit of Information Technology (IT) systems focusing on the IT control environment, IT security and application controls in financial management and human resource management information systems and a discussion of the implementation of the whole-of-government data centre strategy and the use of legacy systems.
- Chapter 5 outlines, for each agency, details of business operations that influence financial statement audit coverage; governance arrangements

---

<sup>9</sup> The Finance Minister's Orders (FMOs) made by the Minister for Finance and Deregulation set out the requirements for the preparation of financial statements of all reporting entities covered by the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.

relevant to the agency's financial statements; areas of audit focus; and any significant and moderate audit issues identified by the 2012–13 interim audits. The chapter is structured in accordance with the portfolio arrangements established by the Administrative Arrangements Order (AAO) of 16 May 2013.

## Acknowledgements

1.7 Based on the work completed during the interim audit phase, the ANAO is well placed to complete the audit program following the preparation by agencies of their financial statements after the close of the 2012–13 financial year. The contribution and cooperation of Chief Finance Officers, other agency staff, and the key role undertaken by audit committee members is greatly appreciated.

## 2. Financial Reporting and Auditing Frameworks

---

*This chapter provides commentary on recent developments in the financial reporting and auditing frameworks relevant to the Australian Government and its reporting entities.*

### Introduction

**2.1** The Australian Government's financial reporting framework is based, in large part, on standards made independently by the Australian Accounting Standards Board (AASB). This framework is designed to support decision making by, and accountability to, the Parliament.

**2.2** The AASB bases its accounting standards on the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). Because IFRS are designed primarily to relate to for-profit organisations, the AASB amends the IFRS to reflect the unique transactions and events of the public and not-for-profit private sectors. In doing so, it takes into account standards issued by the International Public Sector Accounting Standards Board (IPSASB). The Finance Minister prescribes additional financial reporting requirements for Australian Government agencies and authorities through the Finance Minister's Orders (FMOs) for financial reporting.

**2.3** Recent additions to Australian Accounting Standards include: the issue of guidance on accounting for the carbon tax; a requirement that most government entities report their performance against budget; and temporary relief for the Australian Government from the requirement to measure defence weapons platforms at fair value. The AASB has also decided that not-for-profit public sector entities should provide the same disclosure of the remuneration of key management personnel as occurs in the private sector.

**2.4** Major developments in accounting standards internationally will continue to be a significant driver of changes to Australian Accounting Standards. At the international level, major changes to accounting standards are well progressed, potentially changing reporting requirements in important areas such as financial instruments, revenue, and leases. The IPSASB is also continuing to develop its conceptual framework for public sector financial reporting.

**2.5** Just as Australian Accounting Standards are based on international accounting standards, the Australian Auditing and Assurance Standards Board (AUASB) bases Australian Auditing Standards on the International Standards of Auditing (ISAs). The ANAO adopts the Australian Auditing Standards.

**2.6** This chapter also outlines major developments in auditing, including progress towards an international audit quality framework and the continuing work to enhance the relevance and reliability of auditors' reports on financial statements.

## Recent changes to the Australian public sector reporting framework

### Carbon pricing

**2.7** The fixed price phase of the Government's carbon pricing scheme commenced on 1 July 2012. To assist the implementation of the associated financial reporting processes, the staff of the AASB released a paper addressing the key financial reporting issues for emitter entities in this initial phase. The AASB has also published a staff paper<sup>10</sup> *Financial Reporting Implications of the Carbon Tax for Government* on the financial reporting issues facing the Australian Government in the fixed price phase.

**2.8** The AASB staff paper calls for the Australian Government to recognise revenue from the carbon tax when relevant emissions occur, measured at the amount received from the sale of emission permits. It also proposes that the Government recognise a liability for refunds expected to be paid to emitters returning unused permits.

**2.9** The AASB has no current plans to issue guidance on financial reporting issues arising in the flexible price period, which commences on 1 July 2015. However the staff paper notes that the AASB may need to consider providing assistance for this phase, should the IASB not issue any pronouncement or guidance in time to provide a basis for accounting treatments.

---

<sup>10</sup> AASB staff papers are not authoritative pronouncements of the AASB.

## Budgetary Reporting

**2.10** The Australian Government prepares its financial statements under AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. The standard requires governments to disclose a comparison of expenditure and revenue against the original budget for the year, and to explain major variances where they are relevant to assessing performance and accountability.

**2.11** The AASB has decided to extend this requirement to all not-for-profit entities in the General Government Sector (GGS)<sup>11</sup>. The AASB has issued AASB 1055 *Budgetary Reporting* to give effect to these requirements, which will apply to reporting periods beginning on or after 1 July 2014.

## Defence weapons platforms

**2.12** AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires government financial statements to align with the principles and rules in the Australian Bureau of Statistics' Government Finance Statistics (GFS) framework, provided the other accounting standards are also followed. For example, plant and equipment must be valued at fair value rather than cost, where fair value can be reliably measured.

**2.13** Recent changes to the GFS framework would have meant that weapons platforms held by the Department of Defence would need to be measured at fair value in the Australian Government Consolidated Financial Statements from 2012–13. The AASB noted that reliably measuring the fair value of weapons platforms raises substantial practical issues and decided that the new requirement would take effect from the 2014–15 financial year. A standard based on this proposal was issued in December 2012.

**2.14** Early consideration will need to be given to the preparatory work required to meet the requirements of this standard by the Departments of Finance and Deregulation, and Defence.

## Transactions with related parties

**2.15** Australian private sector entities must comply with AASB 124 *Related Party Disclosures*, which requires the disclosure of transactions with related

---

<sup>11</sup> The General Government Sector comprises all government entities other than those primarily engaged in producing goods and services for the market.

parties. Related parties include key management personnel and other entities or persons who control or significantly influence the entity, together with close family members of such persons.

**2.16** In July 2011 the AASB decided that the AASB 124 requirement to disclose the remuneration of key management personnel should also apply to public sector entities. Key management personnel, in the public sector context, would usually include Ministers as well as some senior public servants. However, given the difficulties in attributing Ministerial remuneration to entities within a Ministerial portfolio, some relief will be available where appropriate remuneration disclosures are made in the financial statements of other entities within the jurisdiction. The AASB plans to issue guidance for the not-for-profit public sector on how to apply AASB 124.

**2.17** The AASB is drafting amendments to AASB 124 to give effect to its decision, with a proposed commencement date of 1 July 2014.

## **Fair value measurement**

**2.18** Several accounting standards in certain circumstances require, or allow, entities to present their assets and liabilities at fair value in the balance sheet. However, the IASB has identified that guidance on measuring fair value is spread among several standards, is often high-level and is sometimes inconsistent between standards. In May 2011, the IASB issued an accounting standard to provide a single source of guidance on fair value measurement. This standard clarifies the definition of fair value, provides a framework for measuring fair value and enhances the associated measurement disclosures. In September 2011, the AASB issued AASB 13 *Fair Value Measurement*, replicating the IASB standard. AASB 13 applies to reporting periods beginning on or after 1 January 2013.

## **Future developments in the Australian public sector reporting framework**

### **Superannuation**

**2.19** AASB 119 *Employee Benefits* has been reissued and is applicable to reporting periods beginning on or after 1 January 2013. The revised standard introduces a single approach for the recognition and measurement of certain superannuation plans. Previously, a number of accounting options were permitted, including the ability to defer the recognition of certain gains and



losses to future periods. Under the revised AASB 119, all gains and losses will be recognised in the period in which they occur. Disclosure requirements have also been revised: they now include disclosure of fair value information for plan assets; sensitivity analysis for major assumptions; and descriptions of the risks associated with the plan.

**2.20** In December 2011, the AASB released further proposals to update the financial reporting requirements for superannuation plans and approved deposit funds. These proposals would bring reporting by these entities more in to line with reporting by other entities subject to Australian Accounting Standards. Following consideration of comments received on its proposals, the AASB expects to issue a new standard by June 2013.

### **Income of not-for-profit entities**

**2.21** Since 2009, the AASB has been exploring alternatives to the current requirements for accounting for appropriations, taxes and grants, known collectively as non-exchange transactions. In February 2011, the AASB decided this project would be broadened to encompass all types of revenue earned by not-for-profit entities. The new standard will be based on the IASB's work in developing an accounting standard on revenue from contracts with customers, with modifications as necessary to address issues specific to the not-for-profit sector.

**2.22** Appropriations, taxes and grants are major transactions for many Australian Government entities and changes to the accounting standards could have a significant impact on the timing of revenue recognition by such entities. The AASB plans to issue an exposure draft of a new standard on income of not-for-profit entities in the first half of 2013.

### **Public-private partnerships**

**2.23** In September 2011, the IPSASB finalised an accounting standard dealing with accounting for government involvement in public-private partnerships. The standard, IPSAS 32 *Service Concession Arrangements: Grantor* takes effect from 1 January 2014. The standard aims to ensure governments fully report public-private partnership assets and their related financing. It also seeks to increase the consistency of public sector reporting of public-private partnerships, which are often significant and complex transactions.

**2.24** The AASB is developing an Australian Accounting Standard based on IPSAS 32.

## **Differential financial reporting - reduced disclosure requirements**

**2.25** The AASB has developed a differential financial reporting regime that provides an option for the majority of reporting entities to reduce their reporting burden. While the regime was legislated in late 2009–10, the relevant standards do not come into effect until 2013–14.

**2.26** The regime distinguishes two tiers of reporting requirements. Entities in the first tier must prepare financial statements in accordance with the full suite of Australian Accounting Standards. Federal, state and territory governments are included in this tier. Entities in the second tier will prepare similar financial statements, but with substantially reduced disclosure requirements. Government-controlled entities may opt for either tier, subject to the requirements of their regulator. The Finance Minister, who performs the role of regulator for Australian Government entities, has yet to indicate whether Australian Government entities will be permitted to use the ‘reduced disclosure regime’.

**2.27** The differential reporting regime provides an opportunity to reduce the administrative workload of Australian Government entities and make their financial reports easier to read, while preserving sufficient disclosures to satisfy the needs of the Parliament.

## **International projects**

### **Conceptual framework projects**

**2.28** AASB standards, especially those applying to the for-profit sector, are largely based on IFRS. The conceptual framework that underpins Australian Accounting Standards is also largely based on the IASB's conceptual framework.

**2.29** In 2008 the IASB commenced a project to review its conceptual framework, in partnership with the United States Financial Accounting Standards Board (FASB). The IASB has finalised chapters dealing with the objective of general purpose financial reporting and the qualitative characteristics of useful financial information, but has put the project on hold while it concludes deliberations on its future work plan.

**2.30** The AASB has decided that the revised framework will be applicable to all Australian reporting entities, although the project's primary focus is on

for-profit entities. The AASB will add to the framework so that it can be applied by not-for-profit entities.

**2.31** The IPSASB, in conjunction with the AASB and other national accounting standards boards, has embarked on a separate project for developing a public sector conceptual framework. To date, IPSASB has issued the first four chapters of its Conceptual Framework addressing: the role and authority of the conceptual framework; the objectives and users of financial reporting; the qualitative characteristics of financial information; and the nature of the reporting entity. Other chapters, which will address the definition, recognition and measurement of elements of the financial statements; and presentation in general purpose financial reports, are being developed.

**2.32** The IPSASB plans to finalise its conceptual framework by March 2014.

### **Long term sustainability of public finances**

**2.33** The IPSASB has begun work on a framework for the reporting of information about the long term fiscal sustainability of government programs, other than those of government business enterprises. This information would complement that provided by traditional financial statements, by facilitating an assessment of the future viability of government programs.

**2.34** In October 2011, the IPSASB issued guidelines on this topic for public comment. The IPSASB is currently considering comments received with a view to releasing final guidelines in mid 2013.

### **Reporting service performance information**

**2.35** In October 2011, the IPSASB released a consultation paper setting out proposals for a framework for the reporting of service performance information as there is considerable diversity between countries in how such information is reported.

**2.36** The framework would adopt a principles-based approach to encourage consistent reporting of service performance by public sector entities. To achieve this, the framework proposes standardised service performance terminology and definitions, but would not mandate how entities would present service performance information.

**2.37** The IPSASB is considering responses received before progressing the project further. It plans to finish the project by June 2014.

## **Financial instruments**

**2.38** The IASB is undertaking a project to improve the usefulness of financial statements by simplifying the classification and measurement requirements for financial instruments. Measurement rules for financial assets will be considerably simplified and more financial assets are likely to be measured at current market values, rather than historical cost. It is proposed that the requirements for financial liabilities would be largely unchanged.

**2.39** The IASB standard arising from this project was published in November 2009, and was given effect in Australia through AASB 9 *Financial Instruments*, applicable for reporting periods beginning on or after 1 January 2015. As currently drafted, this standard does not replace all existing accounting rules for financial instruments. The IASB is still finalising its proposals for hedging and asset impairment and released its initial views on general hedge accounting for public comment in September 2012.

## **Leases**

**2.40** The IASB is conducting a project to develop a new approach to lease accounting. Many shorter term leases are not shown as assets or liabilities on the balance sheet; instead, lease payments are expensed over the lease term. The IASB issued proposals in 2010 that, if implemented, would see entities with shorter term leases recording the present value of lease payments as assets on their balance sheets, together with corresponding liabilities.

**2.41** The IASB issued an exposure draft of a new accounting standard on leases in May 2013.

## **Revenue**

**2.42** The IASB is progressing a project to provide clearer principles on when revenue from contracts with customers should be recognised and how such revenue should be reported. These principles would apply to all contracts with customers except leases, financial instruments and insurance contracts.

**2.43** The main objectives of this project are to:

- remove inconsistencies and weaknesses in existing revenue recognition standards by providing clear principles for revenue recognition in a robust framework;

- provide a single revenue recognition model which will improve comparability over a range of industries, companies and geographical boundaries; and
- simplify the preparation of financial statements by reducing the number of requirements.

**2.44** The key principles on which the proposed model is based<sup>12</sup> are generally consistent with current Australian practice.

**2.45** The IASB has considered comments from constituents and expects to issue an accounting standard in 2013.

### **Public sector combinations**

**2.46** In June 2012, the IPSASB released for comment a consultation paper on public sector combinations, that is, transfers of assets and liabilities between government entities. This project aims to develop principles-based guidance on accounting for public sector combinations. The consultation paper describes different types of public sector combinations and explores possible approaches to recognition and measurement.

**2.47** The IPSASB plans to release an accounting standard on this topic in late 2014.

### **GFS-GAAP harmonisation**

**2.48** In June 2011, the IPSASB commenced a project to analyse the differences between IPSASB accounting standards and the Government Finance Statistics Manual of the International Monetary Fund, and evaluate the extent to which harmonisation between the two might be feasible. This is similar to past exercises undertaken by the AASB that lead to GFS-GAAP harmonisation for financial reporting by governments in Australia.

**2.49** The IPSASB plans to release an exposure draft on this topic in September 2013.

### **Financial statement discussion and analysis**

**2.50** In March 2011, the IPSASB commenced a project to develop guidance on financial statements discussion and analysis, that is, narrative reporting by

---

<sup>12</sup> Revenue is recognised when goods or services are transferred to the customer, measured at transaction price.

entities to accompany the financial statements. The IPSASB issued draft guidance in March 2012 and is currently considering comments received.

**2.51** The IPSASB plans to issue an accounting standard on this topic by the end of 2013.

## **Consolidation**

**2.52** In May 2011, the IASB released three accounting standards clarifying the requirements for the consolidation of subsidiaries and special purpose vehicles<sup>13</sup>, and requiring the substance of joint arrangements to be disclosed. The changes are intended to give investors a clearer picture of the nature and extent of an entity's involvement with other entities. In August 2011, the AASB released three Australian Accounting Standards to replicate the IASB standards. These standards will not be mandatory for not-for-profit entities until 1 January 2014, giving the AASB time to develop guidance for the not-for-profit sector.

**2.53** In August 2011, the IASB also released proposals to change the consolidation rules for entities defined as 'investment entities'. Under the proposals, an investment entity would not consolidate the assets and subsidiaries of its subsidiaries. Instead, the investment entity would measure its holding in subsidiaries at fair value, similar to other investments the parent entity may hold.

**2.54** The AASB has developed guidance on control in the not-for-profit public and private sectors, which it issued as an exposure draft in March 2013.

## **Developments in auditing standards**

**2.55** Section 24 of the *Auditor-General Act 1997* requires the Auditor-General to set auditing standards with which persons performing ANAO audits must comply. The ANAO Auditing Standards incorporate, by reference, the current versions of standards made by the AUASB, including the Australian Auditing Standards which establish mandatory requirements and provide explanatory guidance for audits of financial statements. As a result, the statutory audits of the financial statements of Australian Government entities conducted by the

---

<sup>13</sup> A special purpose vehicle (SPV) is a financial entity created for a specific purpose and for a limited use. Its operations are limited to the acquisition and financing of specific assets. A SPV is usually a subsidiary entity with an asset/liability structure and legal status that makes its obligations secure even if the parent entity goes bankrupt.

ANAO conform with the standards that apply to the broader auditing profession in Australia.

**2.56** The AUASB uses International Auditing Standards (ISAs) as the basis for the Australian Auditing Standards. ISAs are made by the International Auditing and Assurance Standards Board (IAASB), an independent standard setting board of the International Federation of Accountants (IFAC). In making its standards and guidance, the AUASB consults formally with organisations representing stakeholders, including users of financial statements, regulators and the accounting profession. The consultative processes are scheduled so the AUASB can consider stakeholder views in making submissions on proposals from the IAASB.

### **Auditor reporting**

**2.57** The top priority of the IAASB continues to be its project on auditor reporting. The objective of the project is to enhance the relevance and usefulness of auditor's reports to stakeholders, including by providing information on areas that, in the judgement of the auditor, were of most significance during the audit. An Invitation to Comment *Improving the Auditor's Report* was released in June 2012; an exposure draft for a standard (tentatively identified as ISA 701) is planned for release in mid 2013.

**2.58** In January 2013, the IAASB released for public comment a Consultation Paper, *A Framework for Audit Quality*. The proposed framework describes the input and output factors that contribute to audit quality at the engagement, firm and national levels. The objective of the framework is to raise awareness of the key elements of audit quality, encourage stakeholders to explore ways to improve audit quality, and facilitate greater dialogue between key stakeholders on the topic. The intention is to generate positive action in the public interest to achieve a continual improvement to audit quality.

### **Other IAASB projects**

**2.59** The IAASB also continued to work on a number of other projects including:

- revision of ISA 720 *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*. The proposed revisions extend the scope of the standard, extend the auditor's responsibilities to include considering other information in light of the auditor's understanding of the entity and its environment,

and include suggested auditor reporting responsibilities which are being considered in the formulation of ISA 701 referred to above;

- updating ISAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, in response to the growing use of ISAE 3000 around the world. Issues being considered include whether the standard should be written for all assurance professionals (whether they are professional accountants or not), the extent to which the standard should be written for direct engagements as well as attestation engagements (attestation engagements involve the assurance client preparing information on which the assurance professional reports), defining and describing the nature of 'reasonable' versus 'limited' assurance engagements and requirements for developing an understanding of internal control. The IAASB is planning to approve a revised standard in September 2013;
- determining whether revisions to the ISAs in relation to auditing financial statement disclosures are required in response to the evolving nature of financial reporting; and
- continuing phase 2 of the ISA Implementation Monitoring project, which is gathering information about the use of the clarified ISAs to determine what, if any changes are needed in order to increase the consistency of understanding and application by practitioners.

## **AUASB projects**

**2.60** In November 2012, consistent with the AUASB's focus on non-financial assurance, the AUASB released a new guidance statement to assist assurance practitioners apply the AUASB standards to greenhouse and energy schemes and programs. The guidance statement was developed in close consultation with the Commonwealth Government's Clean Energy Regulator and registered greenhouse and energy auditors.

**2.61** In December 2012, the AUASB, in conjunction with the Water Accounting Standards Board (an independent advisory body to the Bureau of Meteorology), issued an exposure draft of a proposed standard *Assurance Engagements on General Purpose Water Accounting Reports (AWAS2)*. The development of this standard is important to improving the quality of water accounting reports.



**2.62** The AUASB revised ASRE 2400 *Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity* and ASRE 2415 *Review of a Financial Report - Company Limited by Guarantee*. The revisions to ASRE 2400 are in line with the equivalent international standard. ASRE 2415 has been updated for the revision to ASRE 2400 and to address new legislation. Both standards were released in March 2013.

**2.63** The AUASB recently released a policy on the harmonisation of Australian and New Zealand auditing standards which is one of the Board's strategic objectives for 2012–13. The aim of the policy is to work with the New Zealand Auditing and Assurance Standards Board toward the establishment of harmonised standards in both countries.

**2.64** Other current projects of the AUASB include:

- revisions to ASA 610 *Using the Work of Internal Auditors* to bring it more in line with the international equivalent. The revisions will provide a more robust framework for evaluating and using the work of an entity's internal audit function. Consequential amendments will also be made to ASA 315 *Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and Its Environment*; and
- developing an exposure draft for a proposed assurance standard on engagements to report on controls, which will replace the existing standard dating from 2002, AUS 810 *Special Purpose Reports on the Effectiveness of Control Procedures*.

## Conclusion

**2.65** Ongoing developments in accounting and auditing frameworks and standards continue to have an impact on the financial reporting responsibilities of public sector entities and on the ANAO's auditing methodology. The ANAO aims to assist entities through ANAO client seminars and publications that explain new regulatory and accounting requirements.

**2.66** While there were few changes in Australian Accounting Standards during 2012–13, significant changes to the financial reporting framework are under way, both in Australia and internationally. A number of the proposed changes will affect the Australian public sector over the next few years, particularly in relation to lease accounting, revenue recognition and the reporting of financial instruments.

**2.67** On the international auditing front, enhancing audit quality and communication continues to be the top priority of the auditing profession in 2012–13. In Australia, the AUASB continues to develop Australian auditing and assurance standards and guidance with an increased focus on non-financial information.

## 3. Summary of Audit Findings and Related Issues

---

*This chapter provides a summary of the ANAO's review of internal controls as part of the audit of the financial statements of major agencies.*

### Introduction

**3.1** The Chief Executives of General Government Sector entities subject to the FMA Act are required to prepare annual financial statements and present them to the Auditor-General for audit.<sup>14</sup> For large entities, the audit is conducted in two main phases, interim and final. The interim phase focuses on an assessment of agencies' key internal controls; in the final audit phase the ANAO completes its assessment of the effectiveness of key controls for the full year, substantively tests material balances and disclosures in the financial statements, and finalises its audit opinion on the agencies' financial statements. This report focuses on the results of the interim audit phase of the 2012–13 financial statement audits of all portfolio departments and other major General Government Sector agencies that collectively represent some 95 per cent of total GGS revenues and expenses.

**3.2** Chief Executives of FMA agencies are required to manage their affairs in a manner that promotes the efficient, effective, economical and ethical use of resources.<sup>15</sup> This requires the development and implementation of effective corporate governance arrangements and internal controls designed to meet the individual circumstances of each entity and to assist in the orderly and efficient conduct of its business and compliance with applicable legislative requirements, including the preparation of annual financial statements that give a true and fair view.<sup>16</sup>

**3.3** The overall objective of an audit of an agency's financial statements, as identified in the Australian Auditing Standards, is to form an opinion on whether the financial statements, in all material<sup>17</sup> respects, are in accordance

---

<sup>14</sup> *Financial Management and Accountability Act 1997* (FMA Act).

<sup>15</sup> FMA Act 1997, section 44.

<sup>16</sup> FMA Act 1997, section 49.

<sup>17</sup> *AASB 1031 Materiality* states that information is material if its omission, misstatement or non-disclosure has the potential, individually or collectively, to influence the economic decisions of users taken on the basis of the financial statements or affect the discharge of accountability by the management or governing body of the entity.

with the Australian Government financial reporting framework.<sup>18</sup> In planning the audit, audit procedures are designed to achieve reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole.<sup>19</sup>

**3.4** A central component of the ANAO's financial statement audit methodology, and the focus of the interim phase of our financial statement audits, is a sound understanding of the agency and its environment, including its internal controls, as they relate to the preparation of the financial statements. This enables the ANAO to make a preliminary assessment of the risk of material misstatement in an agency's financial statements and to plan an audit approach to reduce audit risk to an acceptable level. The ANAO reviews and evaluates an agency's key internal controls to assess their capacity to prevent and detect errors that may result in a material misstatement of the financial statements. In doing so, the ANAO recognises that the reliability of business processes, accounting records and financial systems can be enhanced through effective internal controls, and this influences the timing and extent of audit work required. The auditor's understanding of the agency, its environment and its internal controls, helps the auditor design the work needed and respond to significant risks that bear on financial reporting.<sup>20</sup> Broad areas of audit focus determined as a result of this planning approach are discussed in chapter 5 for each agency covered by this report.

**3.5** In accordance with generally accepted audit practice, the ANAO accepts a low level of risk that the audit procedures will fail to detect that the financial statements are materially misstated. This low level of risk is accepted because it is too costly to perform an audit that is predicated on no level of risk. Specific audit procedures are performed to ensure that the risk accepted is low. These procedures include, for example, obtaining knowledge of the entity and its environment, reviewing the operation of internal controls, undertaking analytical reviews, testing a sample of transactions and account balances, and confirming significant year end balances with third parties.

---

<sup>18</sup> The key elements of this framework are set out in appendix 3.

<sup>19</sup> *ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*, paragraph 6.

<sup>20</sup> Significant risks are those risks of material misstatement of the financial statements that, in the auditor's judgement, require special audit consideration.

## Internal control

**3.6** The ANAO uses the framework in ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* to consider the impact of different elements of an entity's internal controls on the design and conduct of an audit. These elements, as detailed in ASA 315, are:

- control environment;
- agency risk assessment process;
- the information system, including the related business processes, relevant to financial reporting, and communication;
- control activities relevant to the audit; and
- monitoring of controls.

**3.7** This chapter discusses each of these elements and outlines our observations in relation to each one, based on our review of relevant aspects of each agency's control environment and the results of our interim audits. As such it includes, where relevant, summary comments on category A, B, C and L1 audit findings.<sup>21</sup>

## Control environment

**3.8** An entity's business and operations influence the control environment, which needs to be carefully reviewed as part of the audit process when assessing the risk of material misstatement in financial systems and reports. ASA 315 at paragraph A69 states:

The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organisation, influencing the control consciousness of its people.

**3.9** In conducting an audit of an entity's financial statements, the ANAO focuses on specific elements of the control environment. In doing this, the

---

<sup>21</sup> Category A findings are significant audit issues. Category B findings are moderate audit issues, Category C findings are minor audit issues and category L1 findings are instances of actual or potential breaches of the Constitution, and instances of non-compliance with other key legislative requirements. These categories are explained in chapter 5, p. 84.

ANAO establishes whether the environment in place comprises elements that contribute positively to establishing a foundation for effective internal control, and whether it minimises both financial and non-financial risks to the entity. This judgement has a major influence on the way that the audit is conducted, including the amount of audit work needed to form the audit opinion. Generally, the main elements reviewed are:

- governance arrangements—including the framework within which an agency's activities for achieving its objectives are planned, executed, controlled and reviewed;
- audit committee arrangements—including the assurance and performance role of the audit committee, its use as a forum for communication between management and internal and external auditors, and the degree of independence and expertise of the committee;
- assurance arrangements—including the internal audit function and quality assurance systems and processes;
- systems of authorisation, recording and procedures—designed to ensure that transactions are processed, recorded and accounted for correctly, including the assignment of appropriate authority and that responsibilities and compliance arrangements accord with applicable legislative requirements; and
- a financial performance management regime—that involves the preparation of financial reports, including comparison of actual results to budgets, variance analysis and relevant commentary to provide assurance about the financial performance of the agency.

**3.10** The ongoing performance and effectiveness of these measures can make a significant contribution to the level of assurance that agency management and, in turn, the ANAO obtains for financial statement purposes.

### *Observations*

**3.11** Agencies have mature governance arrangements in place to provide direction, guidance and control over the financial management of their organisations. Executive management committees met regularly to plan and monitor strategic direction and performance. Each agency produces a corporate plan or similar document that outlines the agency's goals and objectives, and thereby facilitate measuring agencies' progress in meeting

them. Chief Executives, their senior management group, and audit or risk committees continued to give attention to financial management and audit matters, risk management and performance outcomes.

**3.12** Agencies have well-established audit committee arrangements. These include a formal charter that outlines each committee's composition, roles, responsibilities and reporting lines, and processes for the regular reporting to the Chief Executive and the periodic self-assessment of performance. To provide guidance to agencies on the composition and role of the audit committee, the ANAO issued a Better Practice Guide *Public Sector Audit Committees* in August 2011. The ANAO observed that generally, agencies have updated their formal charters to incorporate the ANAO's recommended best practice.

**3.13** The ANAO observed that agencies review their Chief Executive's Instructions (CEIs) periodically, with the objective of ensuring that they remain relevant. In addition, delegations and authorisations were regularly reviewed and updated.

**3.14** Consistent with previous years, consideration of the financial position regarding current and future operations is included on the agenda of agencies' executive management meetings. These meetings are usually held monthly, but some agencies have weekly and fortnightly meetings. Financial performance reports to agencies' executives included budget forecasts and commentary on performance. The financial information provided to the agencies' executives was generally supplemented by non-financial operational information, to provide a balanced view of performance.

## **Legislative compliance**

**3.15** The financial framework for the Australian Government agencies included in this report is established by the FMA Act and its subsidiary legislation. The key feature of the framework is that the Chief Executive of each agency is responsible for the financial management of their agency, including compliance with applicable laws and associated policies.

**3.16** In reviewing an agency's control environment, the ANAO assesses whether management has established adequate controls to enable the agency to comply with key aspects of the FMA Act.

**3.17** In more recent years, the ANAO has increased its focus on legislative compliance as part of its financial statement audit coverage. This recognises

the importance of the authority that the Parliament has conveyed to the executive Government in relation to these arrangements and the concerns expressed by the JCPAA in the past in relation to legislative compliance by agencies.

**3.18** The coverage by the ANAO involves assessing key aspects of legislative compliance in relation to annual appropriations, special appropriations, special accounts and the investment of public monies. Audit testing includes confirming the presence of key documents or authorities, and testing of relevant transactions directed at obtaining reasonable assurance about agencies' compliance with these key components of the financial management framework. ANAO audits also review the results of compliance self-assessment and processes and other reviews undertaken in the context of agencies' Certificate of Compliance responsibilities that involve the annual reporting to the Finance Minister of any known breaches of the financial management framework.

### *Observations*

**3.19** As in previous years, overall, the ANAO identified a high level of compliance in these areas, except in respect of potential or actual breaches of section 83 of the Constitution, which is discussed at paragraphs 3.26 to 3.29 below.

**3.20** The 2012–13 interim audits identified that, generally, agencies continue to maintain updated listings of the laws, regulations and associated government policies that are relevant to their responsibilities. Agencies also have well-established processes to monitor compliance with legislation. Processes are implemented by agencies to review the effectiveness of how the agency is monitoring compliance with the relevant laws, regulations and applicable government policies to enable Chief Executives to provide an annual Certificate of Compliance to their Minister.

**3.21** Generally, audit committees are responsible for reviewing the effectiveness of legislative compliance arrangements, particularly in relation to financial management requirements. An agency's internal audit function often assists with the monitoring of these arrangements.

**3.22** Agencies also have established a variety of mechanisms to communicate the importance of compliance with legislation through documents such as Chief Executive Instructions, corporate plans, fraud control plans and delegation instruments.



**3.23** The Certificate of Compliance process for FMA Act agencies was introduced in 2006–07 to improve compliance with the Australian Government’s financial management framework and to ensure that Ministers are kept informed of compliance issues within their portfolios. Through the Certificate, agency Chief Executives certify to their Portfolio Minister the agency’s compliance with the components of the Government’s financial management framework for the previous financial year.

**3.24** The Certificate requirement that Chief Executives sign-off on compliance with the financial management framework and report identified instances of non-compliance has heightened the focus of agencies on compliance.

**3.25** As part of the 2012–13 interim audit the ANAO reviewed agencies’ progress in addressing the risk of breaches of section 83 of the Constitution.

#### Section 83 of the Constitution

**3.26** Section 83 of the Constitution provides that no money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law. The effect of section 83 is that all spending by the Executive Government from the Consolidated Revenue Fund (CRF) must be in accordance with an authority given by the Parliament. Breaches of section 83 can occur when conditions legislated by the Parliament are not met before payments are made from special appropriations and special accounts. In these circumstances the payments may be made without a valid appropriation. This includes situations where an administrative error such as a duplicate payment occurs, even if the overpayment is able to be recovered.

**3.27** Potential breaches can take many forms, including:

- a payment or overpayment made as a result of an error, including payments made based on incorrect or inaccurate information used in assessing payment eligibility; or
- a payment made despite certain legislative preconditions, such as those that regulate an entitlement to a payment, not being fulfilled.

**3.28** As reported in Audit Report No.16 2012–13, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2012*, the 2011–12 financial statements of 20 agencies, including 15 of the agencies covered by this report, included a reference to potential and/or actual breaches of section 83 of the Constitution. The auditors’ reports on the financial

statements of these agencies contained a report on other legal and regulatory requirements which drew attention to these disclosures due to the importance of these disclosures in a public sector context, but the reports were unqualified as the financial statements fairly represented the financial operations and position of the agency at year end.<sup>22</sup>

**3.29** As part of the 2012–13 interim audit phase, the ANAO reviewed progress made by agencies in assessing the ongoing risk of breaches of section 83 of the Constitution and actions taken to address these risks. It is important that agencies continue to take action to reduce the risk of section 83 breaches in relation to payments out of special appropriations and special accounts for which they are responsible. Chapter 5 of this report includes details of these reviews for relevant agencies.

## Agency risk assessment process

**3.30** An understanding of an agency's risk assessment process is essential to an effective and efficient financial statement audit. The ANAO reviews how agencies identify risks relevant to their financial statements, how these risks are managed and considers the risk of material misstatement of an agency's financial statements.

**3.31** The ANAO found that all agencies have well established arrangements in place that involve developing and updating risk management plans at the organisational and work area levels. Oversight of the process is provided by the agency's audit committee or a separate committee with specific responsibility for risk management.

## Fraud control management

**3.32** *The Commonwealth Fraud Control Guidelines* outline the principles for fraud control within the Australian Government and set minimum standards to assist agencies in carrying out their responsibilities to combat fraud<sup>23</sup> against their programs.

---

<sup>22</sup> A report on other legal and regulatory requirements is a separate part of the auditor's report on the financial statements and does not affect the auditor's opinion on the truth and fairness of the financial statements.

<sup>23</sup> The *Commonwealth Fraud Control Guidelines* define fraud against the Commonwealth as 'dishonestly obtaining a benefit, or causing a loss, by deception or other means'. This definition includes (but is not limited to) theft; accounting fraud (false invoices, misappropriation etc); causing a loss, or avoiding and/or creating a liability; providing false or misleading information to the Commonwealth, or failing to provide information where there is an obligation to do so; misuse of Commonwealth assets, equipments or facilities; making, or using false, forged or falsified documents; wrongfully using Commonwealth information or intellectual property.

**3.33** The importance of agencies establishing effective fraud control arrangements is recognised in section 45 of the FMA Act which specifies that Chief Executives must implement a fraud control plan for their agency. The Guidelines require agencies to conduct fraud risk assessments at least every two years. All agencies are required to provide the Australian Institute of Criminology (AIC) with fraud control information for its annual report on fraud against the Australian Government, and fraud control arrangements within Australian Government agencies. This report is titled *Fraud against the Commonwealth: Annual Report to Government*. The report is provided to Government to facilitate analysis of fraud and future policy development.

**3.34** Unaudited data provided to the AIC for the year ended 30 June 2012 showed that:

- the Australian Federal Police accepted 65 referrals of fraud-related matters in 2011–12 and estimated the value of these cases to be \$120.8 million;
- 1 517 defendants were referred to the Commonwealth Director of Public Prosecutions for prosecution and 1 599 defendants were prosecuted by the Commonwealth Director of Public Prosecutions in fraud type matters; and
- during 2011–12, 1 268 convictions for fraud were achieved and there were 11 acquittals for fraud type matters.

**3.35** These results continue to highlight the risk of fraud and the importance of agencies effectively managing their fraud control responsibilities.

**3.36** An explanation of an auditor's responsibility for preventing and detecting fraud is provided in Australian Auditing Standard ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, which notes in paragraph 4:

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

**3.37** In considering the risks of material misstatement of the financial statements due to fraud, ASA 240 requires that a number of audit procedures be undertaken. These include making enquiries of agencies regarding their risk assessment processes for identifying and responding to the risks of fraud, and the controls that management has established to mitigate these risks.

**3.38** As with risk management plans, fraud control plans need to be reviewed regularly and updated when significant changes to roles or functions occur, so that they reflect an agency's current fraud risk and control environment. There are benefits in agencies assessing their fraud risks as part of their risk management processes.

#### *Observations*

**3.39** ANAO enquiries, as part of the 2012–13 interim audits, identified that agencies continue to recognise the importance of adhering to the Fraud Control Guidelines, with fraud control planning being well established in most agencies. The ANAO has observed that most agencies have a formal process implemented for updating fraud control plans and have established formal processes for the implementation, oversight and monitoring of fraud control strategies and initiatives.

### **Information system**

**3.40** In all agencies, information systems are used extensively for financial management and reporting, as well as for human resource management processes. As a consequence, the review of these information systems and their related controls forms a significant part of the ANAO audit examination of internal controls. Information system controls include agency-wide general controls that establish an agency's IT infrastructures, policies and procedures, together with specific application controls that validate, authorise, monitor and report financial and human resource transactions.

#### *Observations*

**3.41** The ANAO observed that most agencies had effective IT general controls and IT application controls that support the preparation of agencies' financial statements, although increased attention to maintaining the effectiveness of the controls was warranted in some agencies. A detailed commentary on the results of the ANAO's review of information systems that underpin the financial transactions processing within major Australian Government agencies is provided in chapter 4.

### **Control activities**

**3.42** Australian Auditing Standard ASA 315 at paragraph A88 states:

Control activities are the policies and procedures that help ensure that management directives are carried out.

**3.43** The auditor is required to obtain an understanding of control activities relevant to the audit, being those that the auditor considers it is necessary to understand in order to assess the risks of material misstatement. Further audit procedures responsive to these risks then need to be designed.

**3.44** To illustrate trends in audit findings over time, aggregate details of category A, B and C findings<sup>24</sup> over the last four years have been grouped into the following categories:

- IT control environment;
- purchases and payables;
- grant accounting;
- accounting and control of non-financial assets;
- revenues, receivables and cash management;
- human resource management processes; and
- other control matters.

### **Aggregate audit findings**

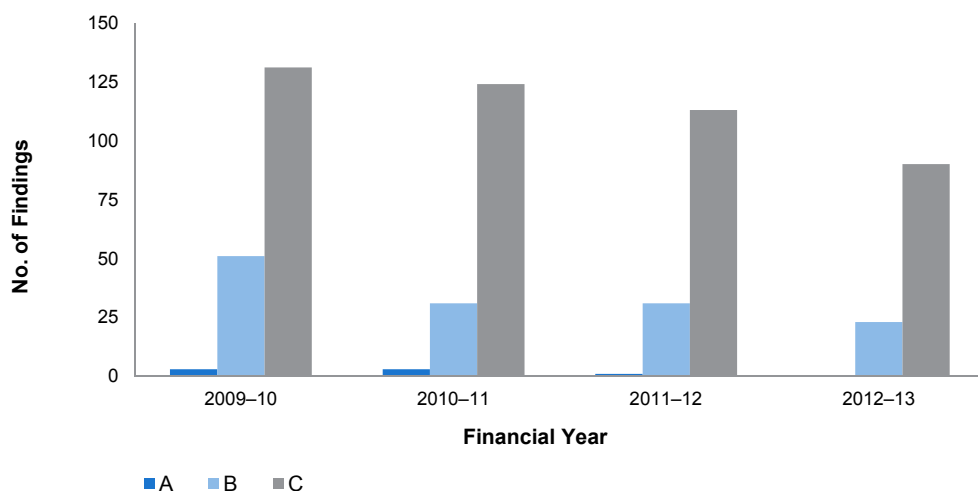
**3.45** Aggregate audit findings for the last four years are outlined in figure 3.1 below.

---

<sup>24</sup> These categories are described at paragraph 5.7 of this report.

**Figure 3.1**

**Aggregate audit findings – categories A, B and C**

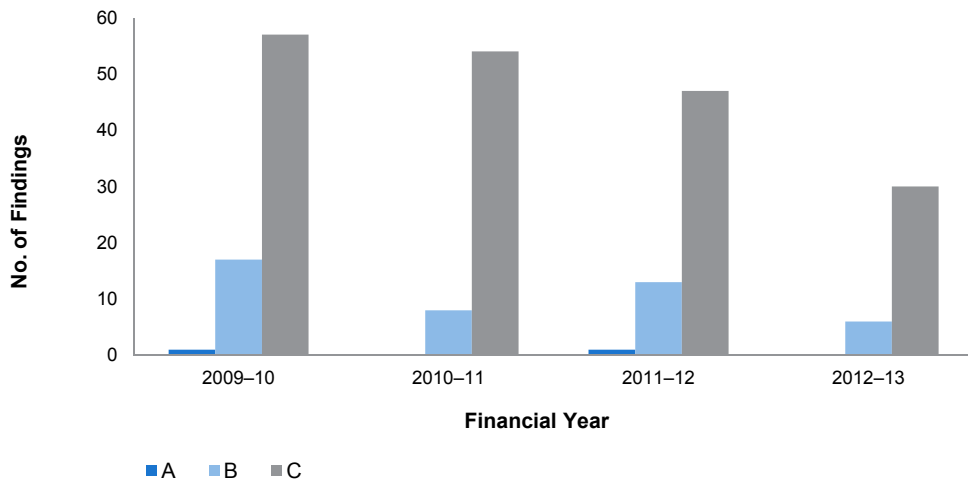


**3.46** Over the last four years the ANAO’s interim audits have identified around 600 audit findings. There has been a progressive reduction in the total number of findings over this period, with the majority (76 per cent) of findings being category C findings. The number of category A and B findings noted during the interim audit phase has decreased from 32 in 2011–12 to 23 in 2012–13. Category C findings have also reduced from 113 in 2011–12 to 90 in 2012–13. The general reduction in audit findings is reflected in the analysis of findings by category outlined below.

**IT control environment**

**3.47** As mentioned above, the review of information systems and their related controls are an integral part of an agency’s internal control environment. The main components reviewed are: IT general controls that encompass an agency’s IT infrastructure, policies, procedures and standards that support accounting and business processes; and IT application controls that validate, authorise, monitor and report financial and human resource transactions.

**3.48** The number of audit findings over the last four years are outlined in figure 3.2 below.

**Figure 3.2****IT control environment – aggregate audit findings**

**3.49** Findings in relation to agencies' IT control environments represent some 40 per cent of all findings, with 234 findings in total over four years. The ANAO observed an overall improvement in the management of IT controls over the past four years.

**3.50** Common issues noted over the four years include controls to manage IT incidents and change management, the regular review and updating of change management processes, and segregation of duties within IT systems. The 2012-13 interim audits have identified a number of issues including the need for improvement in FMIS and HRMIS user access, particularly privileged user access management, in a small number of agencies.

**3.51** A detailed commentary on the results of the ANAO's review of information systems that underpin the financial transactions processing within major Australian Government agencies is provided in chapter 4.

## **Purchases and payables**

**3.52** The main component of purchases and payables is payments to suppliers, including contractor and consultancy expenses, lease payments and general administrative and utility payments. Payments to suppliers generally represent a significant percentage of total departmental expenses incurred by agencies.

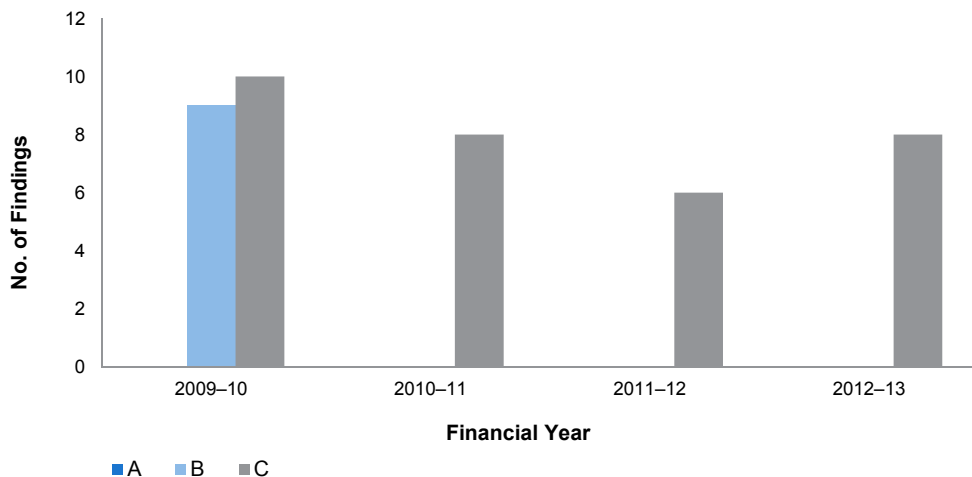
3.53 In 2011–12, the Consolidated Financial Statements (CFS) reported total expenses for the payments of goods and services of \$79.1 billion.

3.54 The main controls over purchases and payables which are given particular focus in our interim audits include: approval of the commitment and expenditure of public monies in accordance with delegations and authorisations; segregation of duties; controls to prevent duplicate payments; reconciliations between the general ledger and subsidiary accounts; and controls over credit card expenditure.

3.55 The number of audit findings over the last four years are outlined in figure 3.3 below.

**Figure 3.3**

**Purchases and payables – aggregate audit findings**



3.56 Over the last four years, agencies’ controls over purchases and payables subject to audit review have been generally effective with a relatively small number of audit findings, representing some seven per cent of total audit findings. The results of our 2012–13 interim audits continue to indicate effective controls in place over purchase and payables. The small number of category C issues identified relate to: a lack of reconciliations of the general ledger with other accounts or key systems; inadequate segregation of duties;



weaknesses in controls designed to ensure the appropriate approval of the payment of public moneys; and lack of controls over credit card expenditure<sup>25</sup>.

## Grant accounting

**3.57** Many agencies administer grant programs that involve the provision of funds to eligible recipients in accordance with legislative and policy requirements. Grant recipients include state and local governments and community organisations.

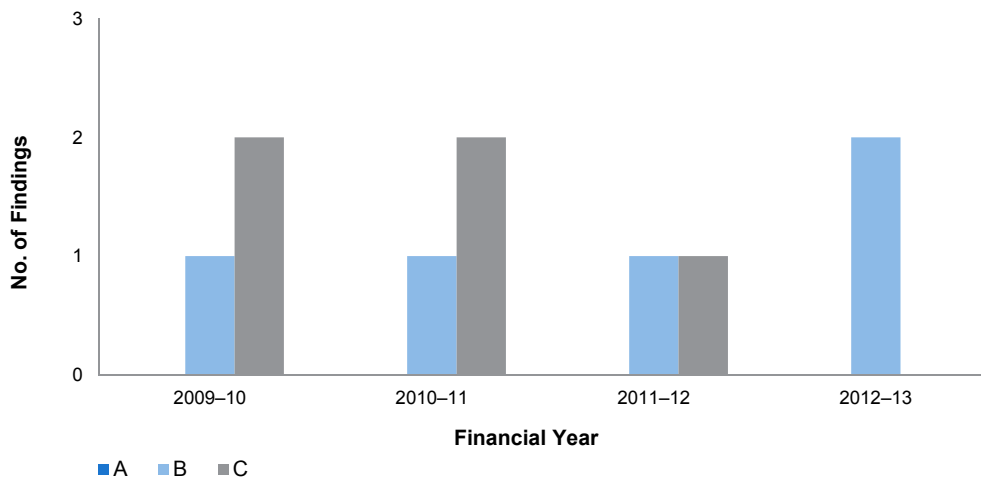
**3.58** The main controls over the accounting of grant expenditure include: approval of the commitment and expenditure of grants to eligible recipients; the payment of grants in accordance with funding agreements; and controls over grant acquittals. Our interim audit work reviewed these control areas.

**3.59** In 2011–12, the Consolidated Financial Statements reported total grant expenditure of \$126.5 billion.

**3.60** The number of audit findings over the last four years are outlined in figure 3.4 below.

**Figure 3.4**

### Grant accounting – aggregate audit findings



<sup>25</sup> In the current financial year, the ANAO tabled ANAO Audit Report No.35 *Control of Credit Card Use* that assessed whether Australian Government agencies were effectively controlling the use of credit cards for official purposes.

**3.61** Agencies' controls over the payment of grants have been generally effective, with a very small number of audit findings representing less than two per cent of total audit findings.

**3.62** Audits of the general administration and the effectiveness of grant programs by agencies are included in the ANAO's performance audit program. These audits generally include: an examination of the program against relevant policy and legislative requirements for the expenditure of public money and the grants administration framework; assessment of processes by which grant applications are sought, received and assessed; and how agencies assess and monitor the achievement of project and program outcomes. Our performance audits continue to identify the need for an improvement in a number of aspects of the administration of grants by agencies, including the assessment and approval of grant applications, monitoring the delivery of programs and the management of funding agreements.<sup>26</sup>

## **Accounting and control of non-financial assets**

**3.63** The accounting and control of non-financial assets represents an important aspect of agencies' financial management responsibilities. Agencies control a diverse range of non-financial assets on behalf of the Commonwealth, with the main classes of assets being land and buildings, leasehold improvements, infrastructure plant and equipment, inventories and internally developed software.

**3.64** In 2011–12, the Consolidated Financial Statements reported total non-financial assets of some \$122.4 billion.

---

<sup>26</sup> In the current financial year, the ANAO tabled the following audits that addressed aspects of the administration of grants:

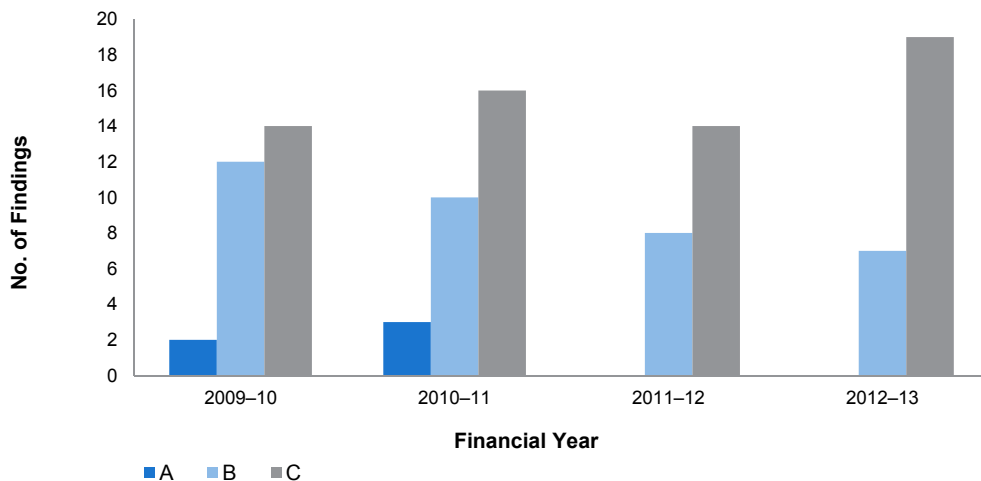
- ANAO Audit Report No.11 2012–13 *Establishment, Implementation and Administration of the Quarantined Heritage Component of the Local Jobs Stream of the Jobs Fund*;
- ANAO Audit Report No.17 2012–13 *Design and Implementation of the Energy Efficiency Information Grants Program*;
- ANAO Audit Report No.22 2012–13 *Administration of the Tasmanian Forests Intergovernmental Agreement Contractors Voluntary Exit Grants Program*;
- ANAO Audit Report No.23 2012–13 *The Australian Government Reconstruction Inspectorate's Conduct of Value for Money Reviews of Flood Reconstruction Projects in Victoria*;
- ANAO Audit Report No.24 2012–13 *The Preparation and Delivery of the Natural Disaster Recovery Work Plans for Queensland and Victoria*;
- ANAO Audit Report No.32 2012–13 *Grants for the Construction of the Adelaide Desalination Plant*; and
- ANAO Audit Report No.37 2012–13 *Administration of Grants from the Education Investment Fund*.

**3.65** The main controls over assets that are given particular focus in our interim audits include: the approval of the commitment and expenditure of public monies in accordance with authorisations and delegations; reconciliations between the general ledger and subsidiary asset accounts; the maintenance of a reliable asset register that includes information about assets acquired, disposed of, and asset locations; physical security over assets including asset identification numbers; the appropriateness of depreciation rates and useful lives; approval of, and the accounting for, the disposal of assets; and the periodic conduct of stocktakes. The valuation of assets is covered as part of our final audit phases.

**3.66** The number of audit findings over the last four years are outlined in figure 3.5 below.

**Figure 3.5**

**Accounting and control of non-financial assets – aggregate audit findings**



**3.67** Over the last four years there have been 104 audit findings relating to the accounting and control of non-financial assets, representing approximately 17 per cent of the total number of audit findings. The results of our 2012-13 interim audits indicate a number of areas requiring improvement. These include issues relating to the capitalisation and disposal of assets values; maintenance of fixed asset registers; timely reconciliations between agencies' asset registers and financial systems; and stocktake procedures.

## Revenue, receivables and cash management

3.68 The main components of revenue and receivables consist of Parliamentary appropriations, taxation revenue, customs and excise duties and administered levies. Other revenue is also generated by agencies from the sale of goods and services and a range of other sources including from interest earned from cash funds on deposit. Cash management involves the collection and receipt of public monies and the management of official bank accounts.

3.69 In 2011–12, the Consolidated Financial Statements reported total taxation revenues of \$316.5 billion, and non-taxation revenues of \$33.9 billion and reported cash holdings totalling \$4.6 billion.

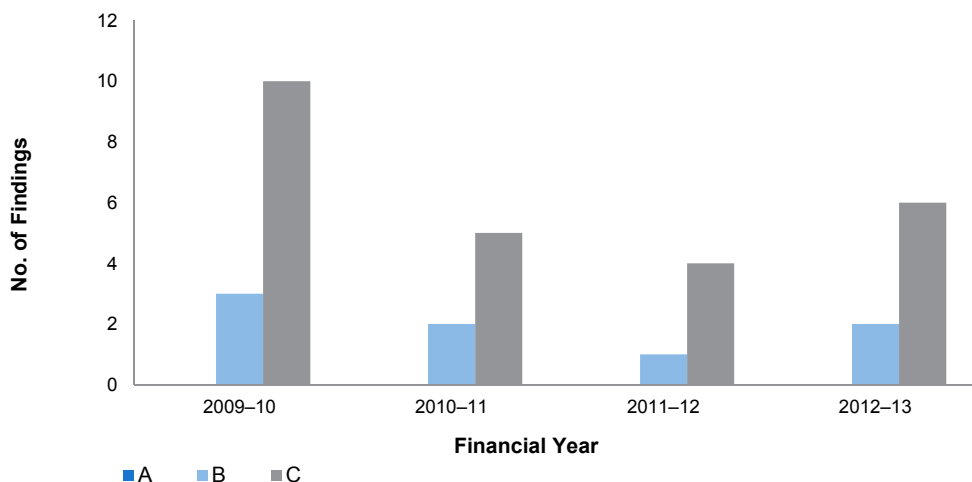
3.70 The main controls over revenue and receivables that are given particular focus in our interim audits include: policies for the recognition of bad and doubtful debts; the regular review of receivables; and the segregation of receipting and recording of cash functions.

3.71 The main controls over the management of cash that are given particular focus in our interim audits include: the approval to open and close bank accounts; the exercise of delegations; and the preparation of bank reconciliations on a regular basis.

3.72 The number of audit findings over the last four years are outlined in figure 3.6 below.

**Figure 3.6**

### Revenue, receivables and cash management – aggregate audit findings



**3.73** Over the last four years, the interim audit phase of the audits has identified that agencies' key controls over revenue, receivables and cash have generally been effective, with audit findings in respect of these areas representing five per cent of total findings.

**3.74** The small number of issues identified relate mainly to reconciliation processes and the management of receivables.

### **Human resource management processes**

**3.75** Human resource management processes encompass the day-to-day management and administration of employee entitlements and payroll functions. The main components of employee expenses consist of salary and wages, leave and other entitlements, employer superannuation contributions, separation and redundancy payments and workers compensation expenses. These items represent the largest departmental expenditure for most agencies. Employee entitlement liabilities, particularly relating to annual and long service leave, generally are one of the larger liabilities on an agency's balance sheet.

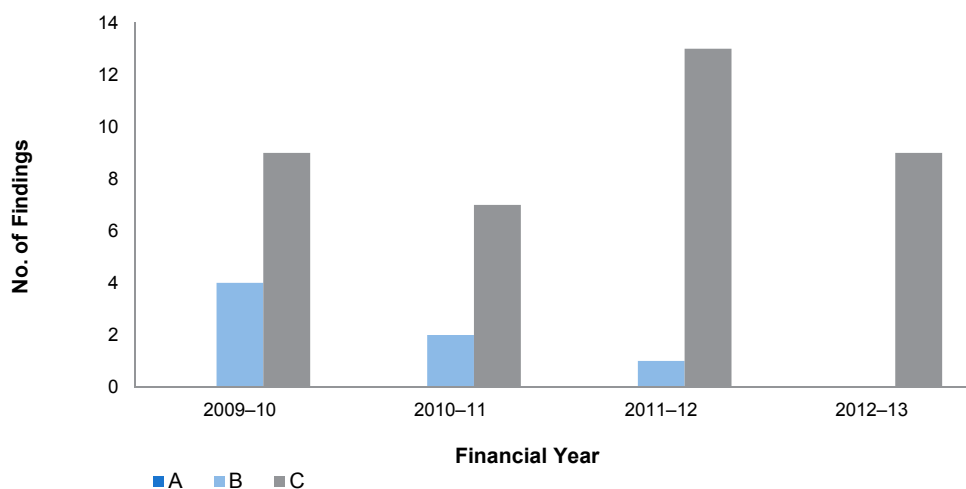
**3.76** In 2011–12, the Consolidated Financial Statements reported \$41.3 billion in employee benefits expenses.

**3.77** The main controls over human resource management processes that are given particular focus in our interim audits include: approvals over new employees; independent checks of employee salary and personnel details entered into the HRMIS; approval of changes of key HRMIS data; independent checks over payroll processes including leave entitlement calculations; the timely conduct and review of reconciliations; and the approval of leave and termination payments.

**3.78** The number of audit findings over the last four years are outlined in figure 3.7 below.

**Figure 3.7**

**Human resource management process – aggregate audit findings**



**3.79** Over the four year period, there have been 45 findings in this category, representing approximately seven per cent of total audit findings. There has been a decrease in the total number of audit findings in this category in 2012–13. Areas where our 2012–13 interim phase audits have identified weaknesses include controls relating to employee provisions and leave and payroll processing.

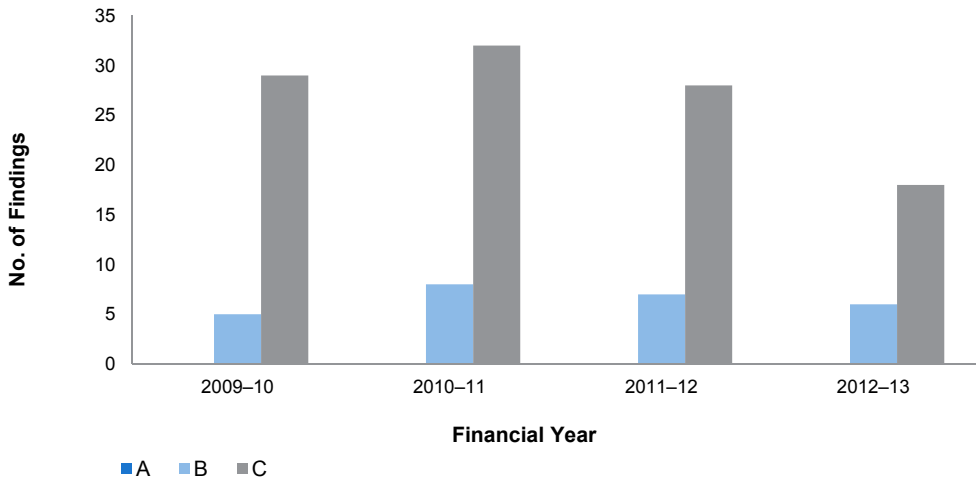
**Other control matters**

**3.80** Our audits also include a review of agencies’ general control environments, particularly when they impact on agencies’ financial statements. Issues considered include such matters as: areas of estimation and judgement; the management of service level agreements and memoranda of understanding; risk management; and financial statements quality assurance processes.

**3.81** The number of audit findings over the last four years are outlined in figure 3.8 below.

**Figure 3.8**

**Other control matters – aggregate audit findings**



**3.82** There have been 136 findings in this category over the last four years, representing approximately 23 per cent of total audit findings. Common issues noted over the four years, and again identified in the 2012-13 interim audit phase, include: control weaknesses across a range of business processes; quality assurance issues and the absence of, or delays in, conducting reconciliations in respect of a number of accounts or key processes.

## Monitoring of controls

**3.83** Australian Auditing Standard ASA 315 at paragraph A98 states:

Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

**3.84** Agencies undertake many types of activities as part of their monitoring of control processes, including external evaluation reviews, control self assessment processes, post-implementation reviews and internal audits. The level of review of different types of activities by the ANAO is dependent on the nature of each entity. However, given the significance of the internal audit function to Australian Government agencies, this function is reviewed by the ANAO each year to gain an understanding of its contribution to the overall control environment.

### Internal audit function

**3.85** In the public and private sectors, internal audit has long been recognised by better practice entities as a valuable resource, and entities have given internal audit a key role in their governance arrangements.

**3.86** Internal audit is a key source of independent and objective assurance advice on an agency's risk framework and internal control. Depending on the role and mandate of an agency's internal audit function, it can play an important role in assessing the adequacy of both the financial systems that underpin an agency's financial statements, and the preparation process.

**3.87** To assist agencies in the management of their internal audit functions, the ANAO issued a Better Practice Guide *Public Sector Internal Audit* in September 2012. The Better Practice Guide outlines the key characteristics of a well performing Internal Audit function. The presence of these characteristics will provide confidence and assurance to Chief Executives and, where relevant, Boards that those financial and operational controls, which manage organisational risks, are operating in an efficient and effective manner.



**3.88** As part of its financial statement coverage, the ANAO reviews the activities of internal audit in accordance with Australian Auditing Standard ASA 610 *Using the Work of Internal Auditors*. The ANAO approach takes into account the work completed by internal audit, and, where appropriate, reliance is placed on it to ensure an effective audit approach. Before reliance is placed on specific internal audit work, ASA 610 requires a number of audit procedures to be undertaken. These may include a review of relevant internal audit working papers, examination of a sample of items already examined by internal audit and observation of internal audit procedures.

### **Observations**

**3.89** The ANAO observed that internal audit coverage is generally based on a work plan that is aligned with agencies' risk management plans and includes a combination of audits that address assurance, compliance, performance improvements and IT systems reviews. In addition, recommendations from management, audit committees and external influences such as the ANAO work program are factors considered in the development of internal audit work plans.

**3.90** Where appropriate, the ANAO places reliance on internal audit work with aspects of the work being used to determine the nature, timing and extent of the ANAO audit procedures. The extent of reliance varies between agencies. Greater reliance is placed on internal audit work where the work is focused on financial controls and legislative compliance. The ANAO continues to encourage agencies to identify opportunities for internal audit coverage of key financial systems and controls as a means of providing increased assurance to Chief Executives to support their expressing an opinion on the agency's financial statements.

**3.91** The ANAO also found that the internal audit functions of most agencies are generally subject to annual review by their respective audit committee or by external reviewers. At the time of the interim audit, those internal audit functions that had been reviewed had been assessed as generally providing a satisfactory service.

## Conclusion

**3.92** The results of our 2012–13 interim audits identified that the effectiveness of controls over finance and accounting processes in the majority of agencies supports the production of reliable financial statement information, reflecting the general maturity of agencies' control environments. Overall, there has been a reduction in the number of findings. However, in a number of categories, there has been a small increase in findings, including accounting and control of non-financial assets, and purchases and payables. Agencies have an ongoing responsibility to monitor the effectiveness of their systems and related controls to be confident of the integrity of the financial information reported to management and in their financial statements.

## 4. Information Technology Controls

---

*This chapter presents the results of the ANAO's review of selected elements of the information technology (IT) control environments that underpin financial transaction processing within major Australian Government agencies. This chapter also includes a discussion of the implementation of the whole-of-government data centre strategy, and the use of legacy systems.*

### Introduction

**4.1** Information Technology (IT) systems facilitate the way in which Australian Government agencies operate and support the business processes that deliver services to the Australian community. Accordingly, systems are required to be accurate, reliable, and sustainable.

**4.2** The Australian Government Information Management Office (AGIMO) has reported that total government IT expenditure for each of the 2008–09 to 2010–11 financial years<sup>27</sup> was around \$5.2 billion. Expenditure for the 2011–12 financial year was around \$6 billion, reflecting an increase in investment in agency technology projects.

**4.3** The business processes that support financial statement preparation and reporting also require the support of IT systems. As a result, an assessment of the IT controls is a core component of the assessment of the agency's control environment, and the financial statement audit process. The ANAO reviews both IT general controls<sup>28</sup> and application controls<sup>29</sup> for significant financial systems.

**4.4** The issues reported in this chapter are matters that have been reported to agencies as category B or C findings. Details of category B findings are included in chapter 5 of this report in relation to the Australian Customs and Border Protection Service and the Departments of Veterans' Affairs, Human Services, and Industry, Innovation, Climate Change, Science, Research and

---

<sup>27</sup> *Australian Government ICT Expenditure, 2008–09 – 2010–11, Version 1.0*, Department of Finance and Deregulation.

<sup>28</sup> IT general controls are agency-wide structures, policies, procedures, and standards applied to information systems that support accounting and business processes. Effective operation of these controls helps make sure IT application controls work as intended throughout the financial year.

<sup>29</sup> IT application controls operate at the accounting and business process level, consisting of access, configuration, and reporting controls. Reliance on the effective operation of these controls provides a means to confirm the accuracy and integrity of agencies financial statements, particularly high transaction volume accounts. Audit coverage of these controls may be undertaken on a rotation basis.

Tertiary Education. Aggregate findings relating to the IT control environment, including category C findings are discussed at paragraphs 3.47 to 3.51 of chapter 3 of this report.

**4.5** The focus of the ANAO's financial statement audits is on risks of material misstatement of agencies' financial statements, however ANAO financial statement audits also provide a valuable insight into IT activities across government.

**4.6** This chapter also includes a discussion on trends observed in the four year period 2009–10 to 2012–13 in relation to a number of IT control categories, commentary on agencies use of legacy systems<sup>30</sup> and the implementation by agencies of the whole-of-government data centre strategy.<sup>31</sup>

## IT control environment

**4.7** The ANAO reviews the design, implementation and operation of key IT controls that are designed to ensure the integrity of financial information presented in agencies' financial statements. The ANAO undertakes this assessment each year in accordance with the Australian Auditing Standards.<sup>32</sup> The accuracy, completeness and integrity of agencies' financial transactions and information are important considerations in formulating an agency's overall audit risk profile and, as such, it is important that controls are well designed and operate effectively.

### Changes to the IT control environment

**4.8** As part of the overall audit approach, an assessment is made each year of significant changes to agencies' control environments. By its nature, the IT control environment is subject to change and modification on a regular basis. For some agencies, changes to their IT systems, applications and processes represent major business change initiatives. Such changes may have a significant impact on the underlying IT control environment.

---

<sup>30</sup> Legacy systems are generally bespoke older systems characterised by increasing costs and an inability to be readily modified to meet new business requirements. Bespoke systems refer to one-off systems, developed in-house or by a third party on behalf of an agency.

<sup>31</sup> *Australian Government Data Centre Strategy 2010–2025*, Australian Government Information Management Office. This strategy provides a whole-of-government approach to future data centre requirements.

<sup>32</sup> Australian Auditing Standard, ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*.

## Elements of the IT control environment

4.9 Table 4.1 below outlines the elements of the IT control environment<sup>33</sup> reviewed by the ANAO as part of the 2012–13 financial statement audits of agencies covered by this report. The total number of agencies can vary from year to year<sup>34</sup>, with 24 agencies reported in 2012–13.

4.10 A more detailed discussion of each IT control environment element is in table 4.1 below.

**Table 4.1**

### Elements of the IT control environment

Control Area	Control Element	Control Categories
General IT controls	IT security management	User authentication and access management Network security Security governance Security monitoring and reporting
	IT change management	Approval and tracking Testing Backout procedures Change logs and reporting Emergency changes Policy and governance frameworks Release management
Application controls	Financial management information system	Application change management Business continuity Masterfile maintenance Payment processing reconciliations Privileged user management User access management
	Human resource management information system	Application change management Business continuity Masterfile maintenance Payroll processing Privileged user management User access management

Source: ANAO compilation.

<sup>33</sup> Given the extensive number of individual controls assessed by the ANAO for each audit; for the purposes of this report, controls comprise a series of elements, for example IT security or IT change management, and elements comprise a series of control categories.

<sup>34</sup> Where comparative data has been included, the data for 2012–13 is for 24 agencies, 2011–12 is for 25 agencies, and 2010–11 and 2009–10 is for 26 agencies.

**4.11** The charts and associated commentary that follow reflect the ANAO assessment of the integrity of general IT controls and application controls, as categorised in table 4.1 above.

## General IT controls

**4.12** General IT controls are the foundation of an agency's IT control environment. These controls commonly relate to all information systems and establish the environment in which application systems and controls operate. The ANAO's review of IT general controls focused on the controls present in the IT environment relevant to those systems that process financial transactions and information.

## IT security management

**4.13** The administration of government programs often involves agencies managing, protecting, and preserving large amounts of financial and personal information. The integrity of such information can be threatened by an IT security event, and risk the accuracy and completeness of an agency's financial information. Some events can also pose a risk to the legal, privacy, and operational responsibilities of agencies, and may result in loss of public confidence.

**4.14** IT security management is the primary mechanism used to protect information and information systems from unauthorised access, use, disclosure, modification, or destruction. The minimum standards for the protection of Australian Government information and data that agencies must meet are outlined in the Protective Security Policy Framework (PSPF)<sup>35</sup> and the Australian Government Information Security Manual (ISM).<sup>36</sup>

**4.15** The ANAO reviewed the following categories of IT security management that are fundamental to safeguarding the security and confidentiality of agencies' financial information:

- user authentication and access management;
- network security;

---

<sup>35</sup> The Protective Security Policy Framework (PSPF) is the source of policies, procedures, and minimum standards for agencies in setting their protective security arrangements.

<sup>36</sup> The Australian Government Information Security Manual complements the PSPF by providing principles and controls to assist Government agencies to achieve an assured IT security environment.

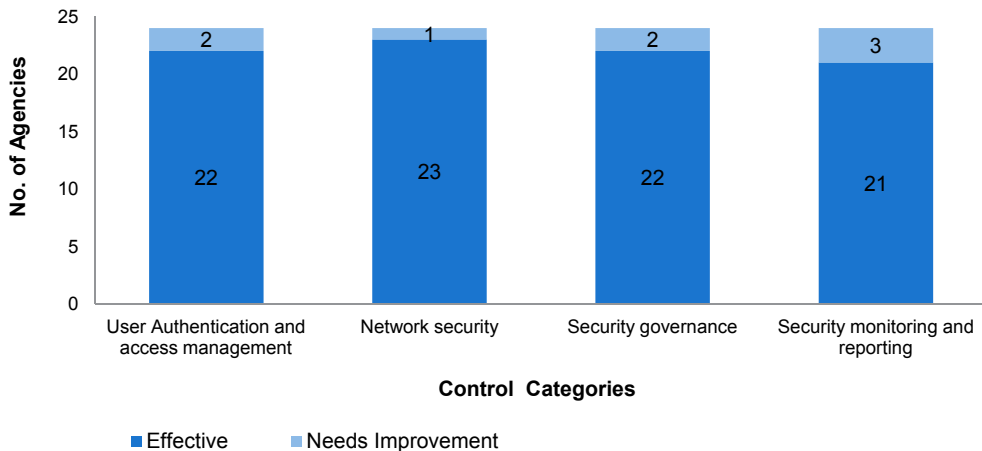
- security governance; and
- security monitoring and reporting.

*Observations*

**4.16** A summary of the ANAO’s assessment of the effectiveness of security control categories within agencies is provided in figure 4.1 below.

**Figure 4.1**

**2012–13 Assessment of IT security management**



**4.17** Overall, the ANAO identified that the security management controls implemented by agencies were effective. In particular, most agencies had established effective security governance frameworks, and had implemented effective controls for managing their IT security responsibilities.

**4.18** Although the audits identified specific security weaknesses in a small number of agencies, no systemic security governance or management failures were observed. Three agencies could make improvements to the monitoring of their IT security arrangements, and two agencies could make improvements to their IT security governance arrangements including approved policies and procedures. Two agencies had weaknesses in their user authentication and access management arrangements, and one agency could make improvements to their network security arrangements.

## **IT change management**

**4.19** Changes to an agency's IT environment are generally managed using a standardised process, although changes relating to the HRMIS and FMIS are sometimes managed through a separate change management process. The findings in figure 4.2 below relate to an agency's standard change management process whereas change management observations relating specifically to HRMIS and FMIS applications are described in figures 4.5 and 4.6. A change management process covers changes to all technology and communications components, including networks, hardware platforms, application software, and requires appropriate supporting documentation. The aim of the change management process is to manage changes in a controlled and timely manner, with a minimal number of incidents or problems occurring on release to the production environment.

**4.20** For changes made to the key business systems, the ANAO tested controls supporting the agency's change management processes in the following key categories:

- approval and tracking;
- testing of changes;
- backout procedures;
- change logs and reporting;
- emergency changes;
- policy and governance frameworks; and
- release management.

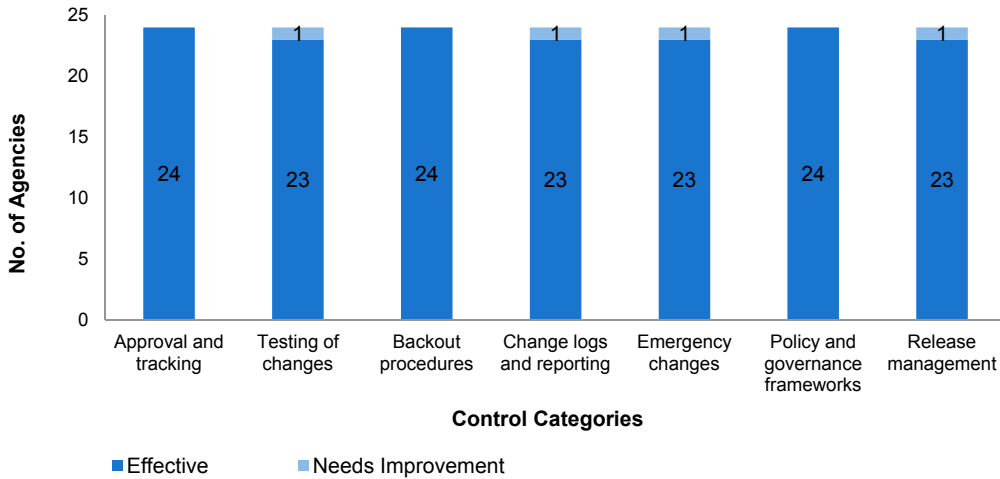
### *Observations*

**4.21** The findings from the testing of IT change management controls are summarised in figure 4.2 below.



**Figure 4.2**

**2012–13 Assessment of IT change management**



**4.22** Most agencies had effective change management policy and governance frameworks, and agencies had generally implemented operational change management practices effectively. However, improvements in change management testing, change logs and reporting, emergency change management and release management are required in a small number of agencies. Weaknesses in change management controls may reduce the level of oversight and control over system changes, and increase the risk of system changes being implemented that may affect the integrity of financial information.

**Application controls**

**4.23** Australian Government agencies generally rely on two key financial reporting systems in the preparation of financial information. These are the financial management information system (FMIS) and the human resource management information system (HRMIS).

**4.24** In view of their importance for financial reporting, the ANAO reviews the key FMIS and HRMIS controls across agencies.

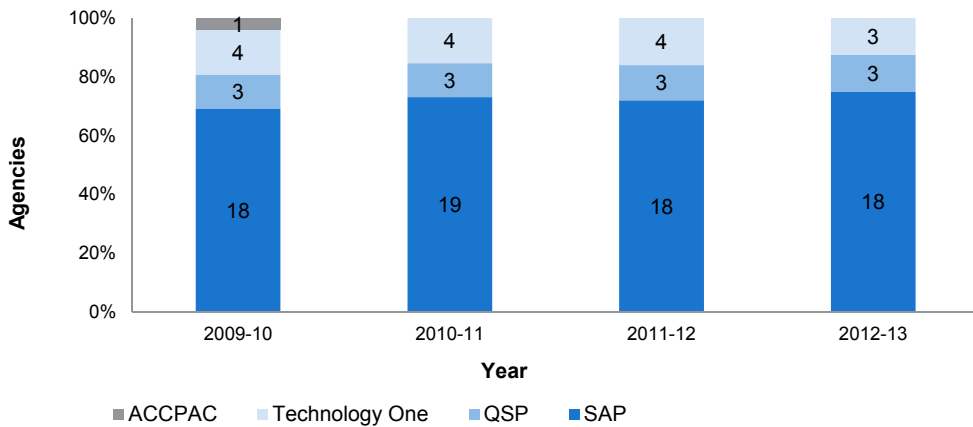
**4.25** The ANAO has recently published an updated Better Practice Guide *Human Resource Information Systems: Risks and Controls* to assist agencies in managing the risks involved in HRMIS functions. The ANAO has also

published a Better Practice Guide, *SAP ECC 6.0 Security and Control*, to assist agencies managing the risks in SAP FMIS environments.

**4.26** The figures below detail the various FMIS and HRMIS applications used by the agencies covered by this report over the last four years.

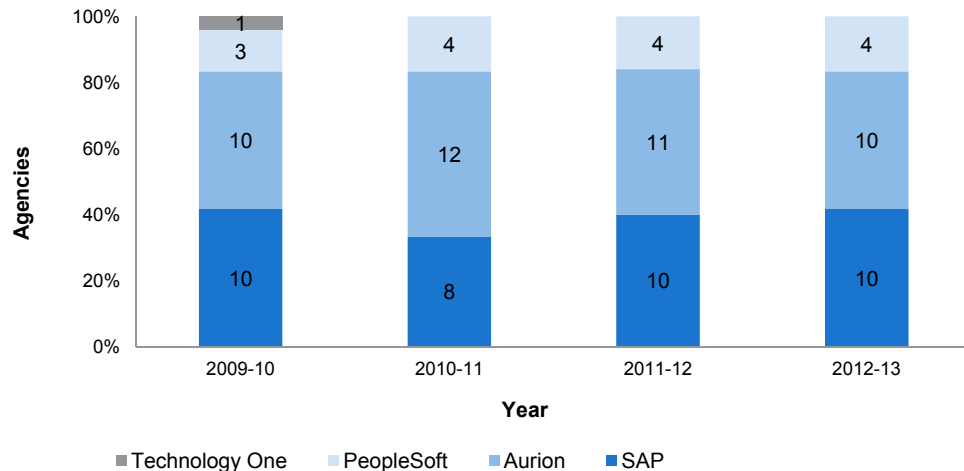
**Figure 4.3**

**Summary of FMIS applications 2009–10 to 2012–13**



**Figure 4.4**

**Summary of HRMIS applications 2009–10 to 2012–13**



**4.27** The ANAO observed that there has been minimal change in the range of applications utilised by agencies over the past four years. The selection and deployment of HRMIS and FMIS are costly projects for agencies and can

impose considerable disruption to business operations. As a result the number of agencies that change systems to an alternative application can be expected to be low.

### **Financial management information systems**

**4.28** The FMIS is the IT application that processes financial transactions and summarises financial information. It supports financial management decision-making, budget and financial planning, and the preparation of agency financial statements.

**4.29** The following FMIS control categories were reviewed as part of the 2012–13 financial statement audits:

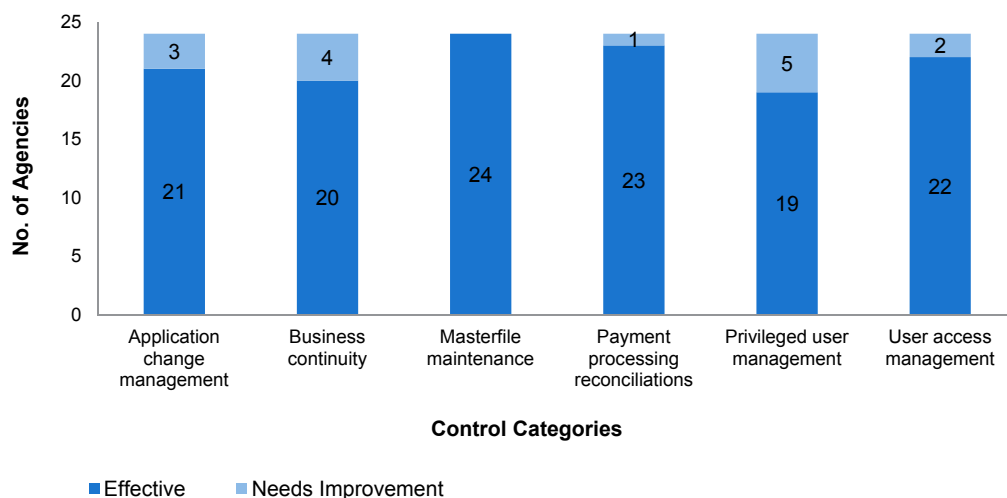
- application change management;
- business continuity;
- masterfile maintenance;
- payment processing reconciliations;
- privileged user management; and
- user access management.

#### *Observations*

**4.30** The ANAO's assessment of the key FMIS control categories integral to effective financial management and reporting, that have implications for the preparation of agencies' financial statements, is summarised in figure 4.5 below.

**Figure 4.5**

**2012–13 assessment of FMIS controls**



**4.31** FMIS privileged user management remains an area requiring improvement in five of 24 agencies. FMIS user access management also required improvement in two agencies. When there is inadequate user access controls, particularly those related to the more powerful privileged user access, there is an increased risk of individuals undertaking actions that may undermine the integrity of financial systems and information. It is therefore important that agencies take steps to address any deficiencies in user access controls.

**4.32** The ANAO identified FMIS change management arrangements required improvement in three of 24 agencies. Without sound change management arrangements in place, it is possible for changes to be implemented without appropriate testing, review, and approval. This may undermine the integrity of financial systems and information.

**4.33** Key FMIS controls used to support the preparation of financial statements were generally effective in most agencies. The reconciliation of payment processing is a key control for maintaining the integrity of financial information, and all agencies except one had effective systems in place to verify that the reconciliation of payment processing files occurred.

**4.34** In addition, four of 24 agencies did not have adequate FMIS business continuity arrangements. Without sound business continuity arrangements there may be a lack of integrity in the financial systems, and information may

not be able to be relied upon in a business disruption event. FMIS business continuity plans should be subject to regular testing and updating, when required.

### **Human resource management information systems**

**4.35** The HRMIS is the IT application that facilitates strategic and operational decision-making for payroll and human resource management. The data held in the system is a major component of the financial reporting process.

**4.36** The key categories of HRMIS controls reviewed as part of the 2012–13 audit coverage were:

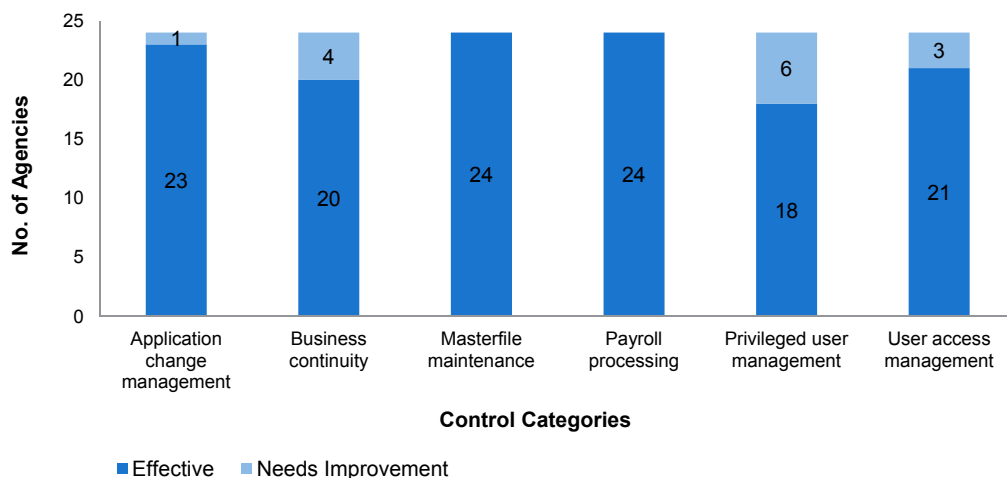
- application change management;
- business continuity;
- masterfile maintenance;
- payroll processing;
- privileged user management; and
- user access management.

#### *Observations*

**4.37** The ANAO's assessment of key HRMIS control categories that enhance the completeness and accuracy of HR financial information is outlined in figure 4.6 below.

**Figure 4.6**

**2012–13 assessment of HRMIS controls**



**4.38** The ANAO identified that in most agencies the key HRMIS controls used to support the preparation of agency’s financial statements were generally effective. However, the ANAO identified that HRMIS privileged user management remained an area requiring improvement in six of 24 agencies. HRMIS user access management also required improvement in three agencies. Having appropriate controls for managing HRMIS system administrators and other users who have high levels of access to HRMIS financial transactions and information is required to manage the risk of inappropriate access and the potential for individuals to undertake actions that may undermine information integrity.

**4.39** In addition, four of 24 agencies did not have adequate HRMIS business continuity arrangements. Any failure in the HRMIS resulting from a business disruption event could have significant consequences for an agency’s capacity to maintain the completeness, accuracy, and availability of HR financial information. HRMIS business continuity plans should be subject to regular testing and updating, when required.

**4.40** HRMIS change management arrangements also remains an area requiring improvement in one agency. Without sound change management arrangements in place it is possible for system changes to be implemented without appropriate testing, review, and approval.

## Trends over the period 2009–10 to 2012–13

**4.41** The ANAO's ongoing assessment of agencies' IT control environments has identified a number of trends over the period 2009–10 to 2012–13 for particular control categories. Some trends point to areas that have improved over the last four years, while others suggest that further management attention is required in a number of agencies due to an increase in the control weaknesses identified in 2012–13. The most significant of these trends is discussed below.

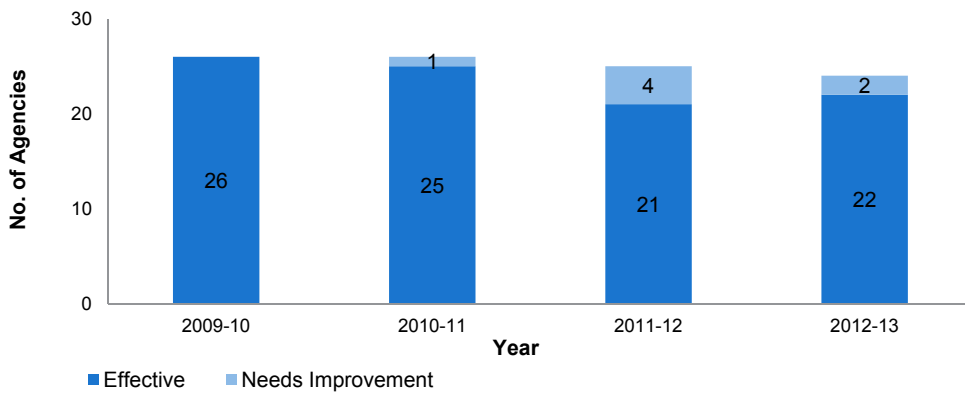
### IT security governance

**4.42** IT security governance frameworks are an overarching set of structures, policies and procedures that address security matters within an agency. Effective security governance frameworks support agencies remaining current with technology innovations and organisation changes, and to be better positioned to manage security threats and incidents including those related to cyber security. Whole-of-government security framework changes, as reflected in the PSPF and ISM, have been refined in 2012–13, and some agency functions continue to change from time to time. As a result, agencies should establish and maintain effective security governance frameworks, and implement related processes and procedures.

**4.43** Until 2010–11 there was a high level of effectiveness of agency security frameworks, followed by a decline in 2011–12 with improvements required in four agencies. In 2012–13 two of 24 agencies continued to require improvement. This trend indicates that continuing management attention is required in this area, as summarised in figure 4.7 below.

**Figure 4.7**

**IT security governance: 2009–10 to 2012–13**



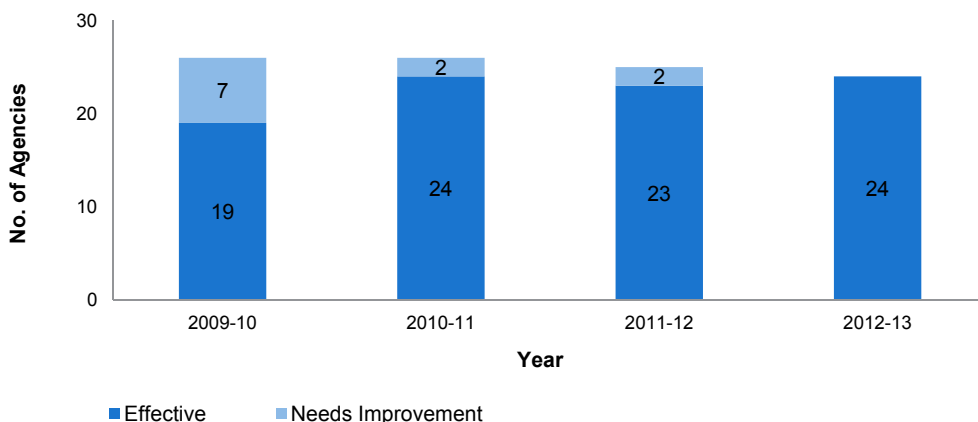
**IT change management policy and governance frameworks**

**4.44** IT change management policy and governance frameworks assist agencies to create a consistent and reliable approach to making changes in their IT environment.

**4.45** As IT environments change, the controls surrounding change management require regular review to maintain their currency and applicability. The ANAO observations regarding change management policy and governance frameworks over the past four years are summarised in figure 4.8 below.

**Figure 4.8**

**Change management policy and governance frameworks: 2009–10 to 2012–13**





**4.46** The policy and governance structures that support change management processes showed a marked improvement across agencies during 2010–11 and 2011–12. Further improvement has been observed during 2012–13, with all agencies having change management governance arrangements in place, including the effective implementation of related policies.

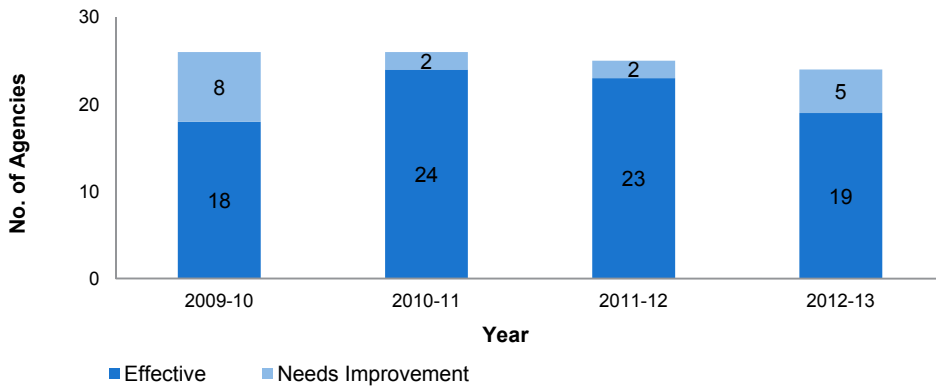
**4.47** A high level of oversight and control over system changes decreases the risk of system changes being implemented that may affect the integrity of financial information, and it is therefore important for agencies to continue to have effective change management policy and governance arrangements in place.

**FMIS privileged user management**

**4.48** FMIS privileged user management involves implementing a regime of system restrictions on users in respect of their access rights to edit and change data within the FMIS. The ANAO observations regarding FMIS privileged user management over the past four years are summarised in figure 4.9 below.

**Figure 4.9**

**FMIS privileged user management: 2009–10 to 2012–13**



**4.49** The administration of FMIS privileged user accounts showed a marked improvement in 2010–11 and 2011–12. However, there has been a decline in 2012–13, with five of 24 agencies having deficiencies in the management of FMIS privileged user accounts.

**4.50** A reduced level of oversight and control over the managing, logging, and effective monitoring of privileged user activities increases the risk of inappropriate system access and activity that in turn may affect the integrity of

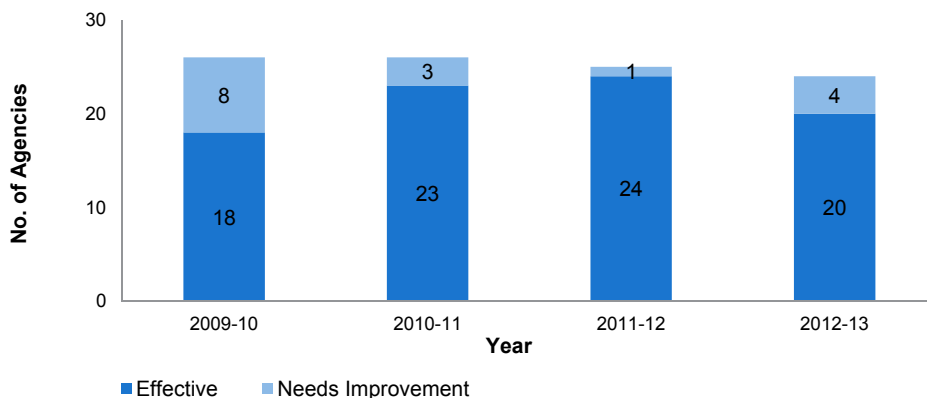
financial information. It is therefore important that some agencies give further attention to ensure effective management of FMIS privileged user accounts.

### FMIS business continuity

4.51 In view of the key role of the FMIS in the effective management of an agency, it is important to have a business continuity plan in place for the agency’s FMIS. The ANAO observations regarding the management of FMIS business continuity risks over the past four years are summarised in figure 4.10 below.

Figure 4.10

#### FMIS business continuity: 2009–10 to 2012–13



4.52 The effectiveness of FMIS business continuity arrangements improved significantly during 2010–11 and improved further during 2011–12. However, there has been a decline in 2012–13 with four of 24 agencies not effectively implementing controls to manage FMIS business continuity risks.

4.53 The ongoing management of business continuity risks requires business continuity plans to be well designed, regularly tested, and updated as required. The decline in effectiveness of FMIS business continuity plans in 2012–13 highlights the importance of agencies establishing and maintaining their business continuity arrangements, increasing the likelihood that agencies will be able to recover financial information if a business disruption occurs.

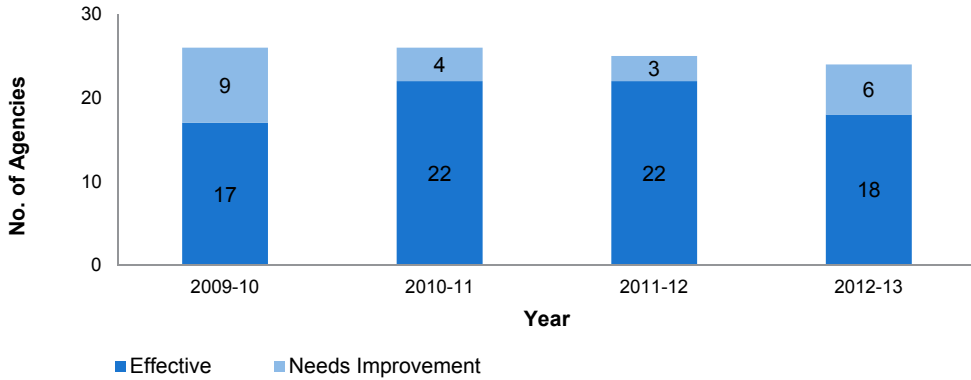
### HRMIS privileged user management

4.54 HRMIS privileged user management involves implementing a regime of system restrictions on users in respect of their access rights to edit and

change data within an agency’s HRMIS. The ANAO observations regarding HRMIS privileged user management over the past four years are summarised in figure 4.11 below.

**Figure 4.11**

**HRMIS privileged user management: 2009–10 to 2012–13**



4.55 In 2010–11 there was a significant improvement in the administration of HRMIS privileged user accounts, and this improvement was maintained in 2011–12, although a small number of agencies continued to require improvement in their management of privileged user accounts. However, there has been a significant decline during 2012–13, with six of 24 agencies not effectively administering HRMIS privileges user accounts.

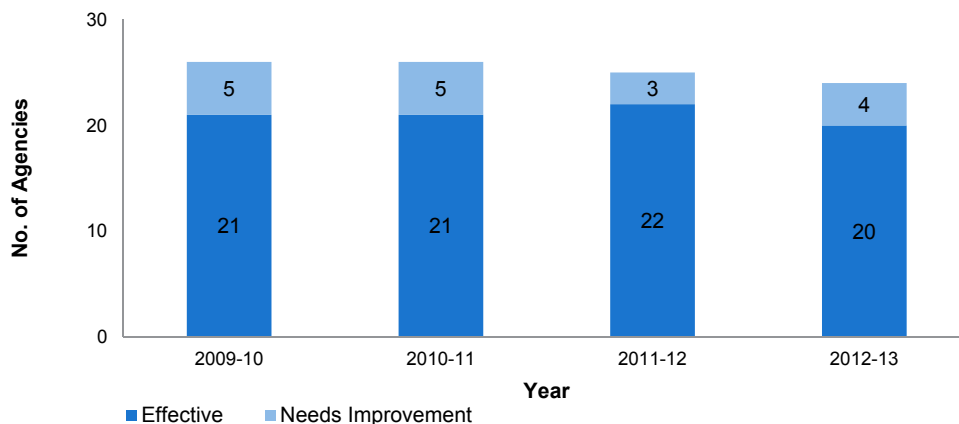
4.56 A reduced level of oversight and control over the managing, logging, and monitoring of privileged user activities increases the risk of inappropriate system access and activity. As privileged users typically have full access to all HRMIS financial transactions and information, there is a risk to the integrity of financial and other information in the HRMIS for agencies concerned, and it is important that agencies take steps to address any control deficiencies.

**HRMIS business continuity**

4.57 In view of the key role of the HRMIS in the effective management of an agency, it is expected that agencies have an HRMIS business continuity plan. The ANAO observations regarding the management of HRMIS business continuity risks over the past four years are summarised in figure 4.12 below.

**Figure 4.12**

**HRMIS business continuity: 2009–10 to 2012–13**



4.58 The effectiveness of HRMIS business continuity arrangements has remained relatively constant over the past four years. A small improvement was observed during 2011–12, however there has been a small decline during 2012–13, with four of 24 agencies not having effective HRMIS business continuity controls.

4.59 Management of business continuity risks requires business continuity plans to be well designed, regularly tested, and updated as required. The decline in the effectiveness in 2012–13 reinforces the importance of agencies establishing and maintaining their business continuity arrangements, to reduce the risk that agencies will not be able to recover human resources information in the event of a business disruption.

### Major technology change activities

4.60 The ANAO reviews the operation and controls of IT systems supporting significant government programs.

4.61 Increasingly, agencies need to make prudent decisions in a tight fiscal environment in relation to information technology investments, and this may affect the capacity of agencies to undertake new business initiatives. This in turn is likely to place pressure on existing systems, including their controls environment.

4.62 As part of the 2012–13 financial statement audits, the ANAO considered the progress of agencies regarding the whole-of-government data

centre strategy, and the management of legacy systems operating across agencies.

## Data centre strategy

**4.63** A data centre is a purpose built facility that supports business systems and its data holdings. Through the provision of computing and communications equipment, controlled power and temperature, security controls, and appropriate monitoring, data is protected and high levels of business systems reliability can be achieved.

**4.64** A whole-of-government data centre strategy<sup>37</sup> was released in March 2010. This 15 year strategy is now in its third year. The data centre strategy is designed to provide significant efficiencies in data costs by 2025, eliminating \$1 billion in future expenditures. In practice, this will result in a reduction in the number of data centres and in the retirement of data centres that are more costly to operate. Particularly in view of the long term nature of lease arrangements, the strategy has a long timeframe for implementation.

**4.65** As part of the data centre strategy, a data centre optimisation targets policy<sup>38</sup> was endorsed in April 2011, with specific targets for agencies to achieve by July 2015. This policy is designed to achieve greater energy efficiency in data centres, through the achievement of data centre energy usage targets.

**4.66** The ANAO has reviewed progress by agencies in addressing the government's data centre strategy, including the achievement of data centre optimisation targets. Progress is summarised in figure 4.13 below.

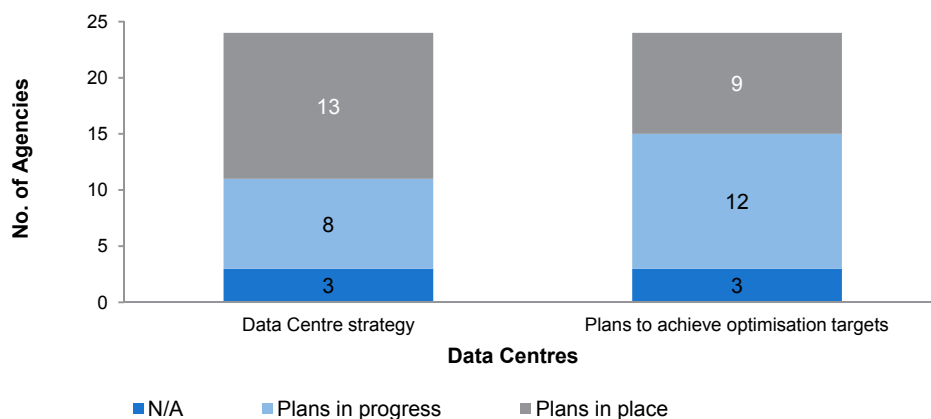
---

<sup>37</sup> *Australian Government Data Centre Strategy 2010–2025*, Australian Government Information Management Office, March 2010.

<sup>38</sup> *Data Centre Optimisation Targets Policy*, Australian Government Information Management Office.

**Figure 4.13**

**Data centre strategy and data centre optimisation targets policy – progress achieved**



**4.67** The ANAO observed that 13 of 24 agencies have developed data centre strategy plans and have commenced data centre consolidation activities; eight agencies have commenced the development of data centre strategy plans, and the remaining three agencies do not operate or require a data centre.

**4.68** The ANAO also observed that nine of 24 agencies had developed data centre optimisation targets, and 12 agencies were in the process of developing targets that address the policy. The remaining three agencies do not operate or require a data centre.

**4.69** A number of agencies have decommissioned or consolidated data centres through the use of the data centre strategy initiatives including:

- utilisation of the data centre facilities panel<sup>39</sup> and the complementary data centre migration services panel<sup>40</sup> to engage a data centre provider independently or in co-operation with other agencies, and to facilitate the transition to the selected data centre; and
- implementing inter-agency solutions using existing agency data centres, using available spare capacity in existing data centres and providing the opportunity to retire less efficient data centres.

<sup>39</sup> 'Data Centre Facilities Panel', listing of approved private sector and government data centre providers, as established and maintained by the Australian Government Information Management Office.

<sup>40</sup> 'Data Centre Migration Services Panel', listing of approved private sector organisations providing data centre migration services, as established and maintained by the Australian Government Information Management Office and available to agencies as required.

**4.70** Agencies must use the data centre facilities panel when making future data centre investment decisions. Trigger events include:

- the end of the life of the data centre;
- a requirement for a significant increase in data centre capacity;
- a major asset replacement, covering for example the procurement of new computing equipment; or
- the expiry of the lease of an existing centre or the end of an outsourcing contract.<sup>41</sup>

**4.71** Three years into the 15 year implementation period, most agencies are making progress to achieve the strategy and optimisation targets. Many agencies advised that they expect to make significant progress during the next 12 months, and that decisions made in this period will be important to the achievement of the strategy.

**4.72** The ANAO will continue to monitor progress in this area.

## Legacy systems

**4.73** Expenditure on maintaining legacy systems<sup>42</sup> represents a significant cost in many agencies. As systems age there are increased risks of rising maintenance costs, challenges in adapting to new or revised business requirements, and increasing difficulties in maintaining such systems given a scarcity of people with the necessary technical knowledge. The risks are more relevant to legacy systems that support administered programs, rather than newer or commercial-off-the-shelf (COTS) systems.

**4.74** The ANAO reviewed the extent of use by agencies of legacy systems; the degree to which agencies have developed legacy systems' replacement plans; and the extent of progress in replacing legacy systems. The results are summarised in figure 4.14 below.

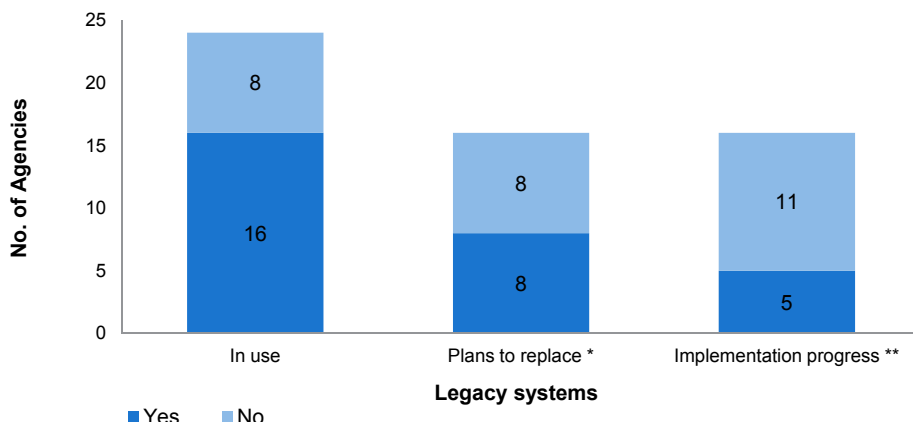
---

<sup>41</sup> *Data Centre Facilities Panel Fact Sheet*, Australian Government Information Management Office.

<sup>42</sup> Op cit (refer footnote 30 on p. 59)

**Figure 4.14**

**Agencies' legacy systems**



\* 'Plans to replace' refers to those agencies that have reviewed their legacy systems and have developed plans for their replacement.

\*\* 'Implementation progress' refers to those agencies that have proceeded to replace legacy systems or have undertaken specific activities towards their replacement.

**4.75** Sixteen of 24 agencies are operating legacy systems. Eight of the 16 agencies operating legacy systems have developed plans for their replacement, with the remaining eight agencies yet to develop replacement plans. Five of the 16 agencies operating legacy systems have undertaken specific activities directed at replacing their current legacy systems, with some legacy systems now replaced.

**4.76** The ANAO also identified:

- Agencies have a range of legacy systems in operation supporting the delivery of significant government outcomes, including the collection of revenue and the payment of grants and personal benefits.
- Legacy systems often operate for longer than their predicted lifespan, given the transition costs and change management complexities associated with significant information technology projects.
- Systems used to support administered programs are increasingly utilising COTS systems. When legacy systems are replaced there is a trend to replace these systems with COTS systems, that is, industry or line of business systems rather than one-off systems. This has occurred



in relation to HRMIS and FMIS requirements<sup>43</sup>, is now occurring to meet grants administration systems requirements, and is beginning to occur to meet benefit payment systems requirements. The use of COTS systems supports the capability to more quickly meet business requirements, improves long term maintainability, and utilises the capability of web based services.

- In recent years under revised funding arrangements, agencies have been required to develop detailed business cases to obtain capital funding for IT investments.

**4.77** Associated with the increased risks with legacy systems, agencies are required to regularly assess the continued viability of such systems to meet future business needs, and the cost effectiveness of maintaining a sound control environment.

## Conclusion

**4.78** The effective implementation and operation of general and application controls assists agencies to provide services in a reliable, timely and consistent manner. Such controls also reduce the risk of financial information being inaccurate, incomplete, or stored insecurely.

**4.79** Improvements evident in 2010–11 and 2011–12 in a range of IT controls were maintained in 2012–13 in a number of agencies. However, there was an increase in weaknesses in a small number of areas including: FMIS and HRMIS user access management, particularly privileged users; FMIS and HRMIS business continuity management; and aspects of IT security management.

**4.80** In future audits, the ANAO will continue to focus on the IT general control environment and on FMIS and HRMIS application controls. This will include user access and privileged user access management, IT security governance, and change management.

**4.81** Agencies have advised that they plan significant progress in the next 12 months with implementation of the data centre strategy. Progress will need to be closely monitored to achieve the \$1 billion of data cost efficiencies as proposed in the strategy.

---

<sup>43</sup> Twenty-two of 24 agencies currently use COTS systems exclusively for their HRMIS and FMIS requirements, and the remaining two agencies use COTS systems for a significant part of their HRMIS and FMIS requirements.

**4.82** A feature of legacy systems is their reduced flexibility to meet changing business needs, as well as increasing maintenance costs. It is important for agencies to develop replacement plans. However, to effect legacy systems replacement, there are significant financial and change management issues to be addressed.

**4.83** The ANAO will continue to monitor agencies' control environments and their progress in implementing government IT policy and in their use of legacy systems.

## 5. Results of the Interim Audit Phase by Agency

---

*This chapter summarises the results of the interim phase of the 2012–13 financial statement audits of the 24 agencies, grouped by portfolio, covered by this report.*

### Introduction

**5.1** This chapter summarises the results of the ANAO’s examination of the internal control of agencies as part of the interim phase of the audits of financial statements for the year ending 30 June 2013. These agencies comprise the portfolio departments and other entities that account for the majority of the financial activities of the General Government Sector, and are listed at appendix 1.

**5.2** The ANAO’s audits of Australian Government agencies are designed to be performed progressively to allow agencies to submit audit cleared financial information to the Department of Finance and Deregulation (Finance)<sup>44</sup> for the purposes of informing the Government of the General Government Sector’s financial outcome for the 2012–13 financial year. The audit reports on agencies’ financial statements are issued following the receipt of signed financial statements and the completion of all audit procedures.

**5.3** The final results of the audits of the agencies covered by this report will be included in the Auditor-General’s report on the audits of financial statements of Australian Government agencies for the year ended 30 June 2013, expected to be tabled in December 2013.

**5.4** This chapter outlines the following information for each agency:

- a summary of the agency’s business operations and the key characteristics of these operations that shape the ANAO’s 2012–13 overall risk assessment and audit coverage;
- key financial balances and staffing levels for 2011–12 and 2012–13;<sup>45</sup>

---

<sup>44</sup> The deadlines for the submission of audit cleared information are 15 August for material agencies and 30 August for non-material agencies.

<sup>45</sup> These figures are sourced from each agency’s 2013–14 Portfolio Budget Statements, audited 2011–12 financial statements, or as advised by agencies.

- governance arrangements relevant to the agency's financial management responsibilities;
- the key areas of audit focus for the audit of the 2012–13 financial statements; and
- any significant and moderate (category A, B and L1) audit findings, and the conclusion relating to the audit coverage undertaken to date.

**5.5** Category C audit findings reported to management relate to relatively minor matters and are not included in this report's summary of audit results for each agency.

**5.6** The ANAO's overall assessment of the risk of material misstatement of the financial statements takes into account, for the purposes of planning the audit coverage, the significance and complexity of each agency's operations as well as the ANAO's knowledge of the agency's internal control. Key audit related business and financial statement risks are also identified and communicated to each agency. The ANAO's interim phase of the audit focuses on the steps taken by agencies to manage risks that have a potential impact on the financial statements, including their systems of internal control.

**5.7** Issues identified during our audits are rated in accordance with the seriousness of the particular matter. The ratings are defined as follows:

- Category A: Issues that pose a significant business or financial management risk to the entity; these include issues that could result in the material misstatement of the entity's financial statements.
- Category B: Issues that pose a moderate business or financial management risk to the entity; these may include prior year issues that have not been satisfactorily addressed.
- Category C: Issues that pose a low business or financial management risk to the entity; these may include accounting issues that, if not addressed, could pose a moderate risk in the future.
- Category L1: Instances of potential or actual breaches of the Constitution; and instances of non-compliance with the entity's enabling legislation, legislation that the entity is responsible for administering, and the FMA or CAC Acts.

**5.8** Category B or C matters remaining unresolved at the time of the subsequent year's audit, depending on the seriousness of the issue, may be given a higher rating.

5.9 The following table provides details of the number of category A, B and L1 findings relating to each agency identified in our 2011–12 and 2012–13 interim audits.

**Table 5.1**

**Significant and moderate findings of agencies grouped by portfolio, reported at completion of the 2011–12 and 2012–13 interim audit phases**

Entity	2012–13 Rating			2011–12 Rating		
	A	B	L1	A	B	L1
Department of Agriculture, Fisheries and Forestry	0	0	0	0	0	0
Attorney–General's Department	0	1	1	0	0	0
Australian Customs and Border Protection Service	0	3	0	1	3	0
Department of Broadband, Communications and the Digital Economy	0	0	0	0	0	0
Department of Defence	0	9	1	0	13	0
Defence Materiel Organisation	0	2	0	0	1	0
Department of Veterans' Affairs	0	4	2	0	6	0
Department of Education, Employment and Workplace Relations	0	1	1	0	1	0
Department of Families, Housing, Community Services and Indigenous Affairs	0	0	1	0	0	0
Department of Finance and Deregulation	0	0	1	0	0	0
The Board of Guardians and the Future Fund Management Agency	0	0	0	0	0	0
Department of Foreign Affairs and Trade	0	0	0	0	0	0
Department of Health and Ageing	0	0	1	0	0	0
Department of Human Services	0	2	1	0	2	0
Department of Immigration and Citizenship	0	0	0	0	1	0
Department of Infrastructure and Transport	0	0	0	0	1	0
Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education*	0	1**	1	0	0	0
Department of the Prime Minister and Cabinet	0	0	0	0	0	0
Department of Regional Australia, Local Government, Arts and Sport	0	0	0	0	0	0
Department of Resources, Energy and Tourism	0	0	0	0	0	0
Department of Sustainability, Environment, Water, Population and Communities	0	0	0	0	0	0
Department of the Treasury	0	0	1	0	3	0
Australian Office of Financial Management	0	0	0	0	0	0
Australian Taxation Office	0	0	0	0	0	1
<b>Total</b>	<b>0</b>	<b>23</b>	<b>11</b>	<b>1</b>	<b>31</b>	<b>1</b>

\* Formerly the Department of Department of Industry, Innovation, Science, Research and Tertiary Education.

\*\* A category B finding was raised for the Department of Climate Change and Energy Efficiency which remained unresolved at the end of the 2011–12 final audit phase. Climate Change functions were transferred to the Department of Industry, Innovation, Science, Research and Tertiary Education as a result of Machinery of Government changes on 25 March 2013.

Source: ANAO.

# Agriculture, Fisheries and Forestry Portfolio

---

## Department of Agriculture, Fisheries and Forestry

**5.10** The Department of Agriculture, Fisheries and Forestry (DAFF) is the primary policy and advisory body to the Australian Government on agriculture, fisheries, forestry and food issues. DAFF's role is to contribute to the overall portfolio aims of enhancing the productivity, competitiveness, and sustainability of Australia's agricultural, food, fisheries and forestry industries.

**5.11** DAFF's business operations include:

- development of systems, policies and regulatory frameworks to support portfolio industries in agriculture, fisheries and forestry;
- business and regulatory reform in relation to biosecurity and quarantine systems, and the eradication and management of nationally significant agricultural and environmental plant and animal pests and diseases in Australia;
- strengthening the sustainable use and management of natural resources, supporting regional forest agreements, regulation of agricultural and veterinary chemicals, and the reform and support of rural research;
- development of the National Food Plan to foster a sustainable, globally competitive, resilient food supply that supports access to nutritious and affordable food;
- improving animal welfare outcomes nationally and internationally and access to global markets for Australia's agriculture, fish, forest and food products; and
- reforming national drought programs, and communicating and helping farmers adjust to the effects of a changing climate.

**5.12** The key characteristics of DAFF's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- a self assessment regime for the collection and reporting of levy revenue;

- a dependency on IT business systems and associated processes, particularly those that support revenue collections and a high number of grants programs; and
- a Memorandum of Understanding between DAFF and the Australian Customs and Border Protection Service that establishes arrangements to collect a range of biosecurity import fees on behalf of DAFF.

5.13 In the light of these characteristics and the ANAO’s understanding of the operations of DAFF, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

### Financial overview

5.14 DAFF’s key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	342	370		
Revenue from government	299	328		
Administered income			438	396
Administered expenses			816	883
Total assets	283	312	302	302
Total liabilities	236	236	91	95

DAFF’s estimated average staffing level for 2012–13 is 4 488 (2011–12: 4 549).

### Governance arrangements

5.15 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DAFF’s business objectives. These arrangements are designed to support DAFF’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.16 The key elements of DAFF’s corporate governance arrangements include:

- a strategic statement that sets out the vision, mission, goals and culture that the department commits to collectively and individually. The

statement is underpinned by annual business plans at divisional level. A People Strategy complements the strategic statement and focuses particularly on how the department will develop its culture and support its people;

- an Executive Management Team (EMT) that meets monthly, provides leadership to DAFF's divisions on administrative and operational aspects, and provides advice to the Secretary on strategic policy, budgets and performance;
- various governance committees that support the EMT, including an audit committee that meets a minimum of five times a year and focuses on financial reporting, internal control structures, risk management systems, internal and external audit functions, and fraud control;
- a financial statements audit sub-committee that meets at least five times a year and oversees the preparation of the annual financial statements;
- an internal audit function that provides planned risk-based audit coverage of DAFF's operations, including its quarantine and biosecurity functions;
- a risk management process that involves updating strategic risk management plans at the departmental and divisional levels; and
- a fraud control plan which outlines DAFF's approach to identifying, monitoring and managing the risk of fraud.

## **Areas of audit focus**

**5.17** In the light of the ANAO's understanding of DAFF's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DAFF's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the accuracy and completeness of primary industry levies and charges revenue and receivables, in light of the complexity involved in estimating agricultural production on which the revenue is based, and the self-assessment nature of collections;
- arrangements for the collection of biosecurity revenue and receivables, of which a significant portion is collected by the Australian Customs and Border Protection Service on behalf of DAFF; and



- grant financial management processes, given the high number and value of grant programs administered by the department.

**5.18** As an integral part of the interim audit phase, the ANAO has also reviewed the IT general and application controls for key systems that support the preparation of DAFF's financial statements.

## Audit results

**5.19** The ANAO has completed its interim audit coverage of the areas of audit focus relating to primary industry levies and charges, and grant financial management.

**5.20** Biosecurity revenue and receivables, and other areas of audit coverage, will be completed as part of the 2012–13 final audit phase.

**5.21** To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

**5.22** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	0	0
L1	0	0	1	1	(1)	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>

### Actual breaches of section 83 of the Constitution

**5.23** The 2011–12 auditor's report included a report on other legal and regulatory requirements referring to 19 actual identified breaches of section 83 of the Constitution, totalling \$83 700, in relation to payments under the *Australian Animal Health Council (Livestock Industries) Funding Act 1996*.

**5.24** As part of the legislative amendments enacted by the *Financial Framework Legislation Amendment Act (No.2) 2012*, amendments were made to the *Australian Animal Health Council (Livestock Industries) Funding Act 1996* in addition to the following Acts:

- *Australian Meat and Live-Stock Industry Act 1997;*
- *Horticulture Marketing and Research and Development Service Act 2000;*
- *Primary Industries and Energy Research and Development Act 1989;*
- *Dairy Produce Act 1986;*
- *Egg Industry Service Provision Act 2002;*
- *Forestry Marketing and Research and Development Services Act 2007;*
- *Pig Industry Act 2001;*
- *Wool Services Privatisation Act 2000; and*
- *National Residue Survey Administration Act 1992.*

**5.25** The ANAO is satisfied that these changes reduce the risk of future section 83 breaches to low.

**5.26** In 2012–13, DAFF is continuing to monitor its level of compliance with section 83 of the Constitution across all legislation for which it is administratively responsible.

## **Conclusion**

**5.27** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DAFF will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Attorney-General's Portfolio

---

## Attorney-General's Department

**5.28** The Attorney-General's Department (AGD) is the central policy and coordinating department of the Attorney-General's portfolio. AGD contributes to the Australian Government's commitment to a stronger, fairer and more secure Australia by striving to achieve a just and secure society through the maintenance and improvement of Australia's law and justice framework and its national security and emergency management system.

**5.29** AGD's business operations include:

- protecting and promoting the rule of law; and
- building a safe, secure and resilient Australia.

**5.30** Key developments in 2012–13 include:

- the establishment of the Royal Commission into Institutional Responses to Child Sexual Abuse (Royal Commission);
- the establishment of an independent taskforce known as the Defence Abuse Response Taskforce, in response to the DLA Piper Report which reported on allegations of sexual and other abuse in the Department of Defence; and
- the transfer of the functions of the former Office of Legislative Drafting and Publishing to the Office of Parliamentary Counsel.

**5.31** The key characteristics of AGD's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the governance and reporting arrangements relating to the administration of personal benefit payments made by the Department of Human Services on behalf of AGD, in the event of natural disasters;
- the large number and value of grant programs administered by the department;
- the establishment of the Royal Commission into Institutional Responses to Child Sexual Abuse; and
- the overall effectiveness of AGD's internal controls.

5.32 In the light of these characteristics and the ANAO’s understanding of the operations of AGD, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.33 AGD’s key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	219	283		
Revenue from government	199	206		
Administered income			19	23
Administered expenses			681	510
Total assets	196	223	469	431
Total liabilities	59	106	26	18

AGD’s estimated average staffing level for 2012–13 is 1 332 (2011–12: 1 482).

## Governance arrangements

5.34 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of AGD’s business objectives. These arrangements are designed to support AGD’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.35 The key elements of AGD’s corporate governance arrangements include:

- a strategic plan that provides an overview of AGD’s strategic priorities and goals, including AGD’s planning and performance framework;
- an Executive Board that meets regularly to consider key strategic matters of corporate importance and sets AGD’s strategic direction. The Board comprises the Secretary and Deputy Secretaries;
- an audit and risk management committee that meets quarterly and is chaired by an external member. The committee is responsible for

overseeing the department's approach to risk management, including AGD's overall control framework and internal audit function;

- an internal audit function that plans and conducts audits based on risk assessments of departmental activities and direction from the audit and risk management committee;
- a risk management framework and risk management plan that addresses a broad range of operational risks; and
- a fraud control plan that is updated and reviewed in line with the Commonwealth Fraud Control Guidelines.

### **Areas of audit focus**

**5.36** In the light of the ANAO's understanding of AGD's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on AGD's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- grant financial management arrangements, given grant expenditure is a major component of AGD's administered accounts, and the operation of a decentralised grants management system which involves multiple and varied practices;
- the reporting of the administered superannuation provision for former Solicitors-General under the Judges Pension Scheme, for which AGD relies on information from the Department of Finance and Deregulation and involves complex reporting requirements;
- reporting of expenditure for the Royal Commission into Institutional Responses to Child Sexual Abuse, given the additional disclosure anticipated in the financial statements and an increased level of stakeholder scrutiny; and
- legislative compliance with statutory and other legal requirements, including constitutional requirements, relevant to special appropriations and special accounts.

**5.37** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of AGD's financial statements.

## Audit results

5.38 The ANAO has completed a review of the internal controls relevant to the preparation of the department’s financial statements. The ANAO has also commenced work in relation to the areas of audit focus identified. Work in relation to these areas will be completed during the 2012–13 final audit phase.

5.39 To date, audit coverage of the key areas of audit focus has identified one new moderate audit issue that is outlined below.

5.40 The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>2</b>

#### *New moderate audit issue*

##### Grant management and reporting arrangements

5.41 The ANAO identified weaknesses in the management and reporting arrangements for a significant grant program, which is administered by the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) and for which AGD has policy, funding and financial reporting responsibilities. The ANAO identified a lack of formal reporting between FaHCSIA and AGD on key aspects of the program and deliverables under the Memorandum of Understanding underpinning the arrangement.

5.42 The ANAO’s review of other significant grant programs also identified weaknesses in the reporting arrangements for any known or forecast grant underspend as at 30 June each year.

5.43 These issues could result in a misstatement in the administered financial statements.

**5.44** AGD is taking action to address this finding with a view to resolving it by the time of the 2012–13 final audit phase.

*Potential breaches of section 83 of the Constitution*

**5.45** The 2011–12 auditor's report included a report on other legal and regulatory requirements referring to 5 577 identified potential breaches of section 83 totalling \$6.9 million, of which \$3.9 million was recovered, in relation to payments under the *Social Security Act 1991* and the *Social Security (Administration) Act 1999*.

**5.46** During 2012–13 AGD continued to monitor compliance with statutory and other legal requirements, including constitutional requirements for which it is administratively responsible. Legislative amendments have been drafted, which aim to reduce the risk of future payments breaching section 83 to low.

## **Conclusion**

**5.47** The ANAO has identified that, based on audit coverage to date, and subject to the resolution of the issue referred to above, AGD's key internal controls were operating satisfactorily to provide reasonable assurance that AGD will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

## **Australian Customs and Border Protection Service**

**5.48** The role of the Australian Customs and Border Protection Service (Customs and Border Protection) is to protect the safety, security and commercial interests of Australians through border protection designed to support legitimate trade and travel. In this role, Customs and Border Protection administers trade measures and certain government industry schemes, as well as collecting trade-related statistics. The collection of border-related revenue including customs duty, passenger movement charges and import processing and depot charges is also undertaken, as is the assessment and collection, where appropriate, of Goods and Services Tax (GST) on imported goods, the Wine Equalisation Tax and the Luxury Car Tax. The Tourist Refund Scheme is also managed by Customs and Border Protection on behalf of the Australian Taxation Office (ATO).

**5.49** Customs and Border Protection's business operations include:

- processing legitimate travel for passengers and crew and making any interventions needed to prevent illegal movement of people and the goods they bring across the border;
- effective border protection for the Australian community by regulating and facilitating legitimate trade and undertaking risk-based interventions to prevent the illegal movement of goods across the border;
- preventing, detecting and deterring prohibited, harmful or illegal goods or people entering Australia or operating illegally in the Australian Exclusive Economic Zone;
- civil maritime surveillance and response, contributing to whole-of-government efforts in detecting, reporting and responding to potential or actual non-compliance with relevant laws in the Australian maritime domain;
- providing assurance that the customs duty, indirect taxes and charges payable on imported goods are correctly assessed, reported and paid, and that revenue concessions, exemptions and refunds are correctly applied; and
- collecting revenue from passenger and crew processing and administering the Tourist Refund Scheme.

**5.50** The key characteristics of Customs and Border Protection's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the management of the Passenger Movement Charge (PMC) levied on each departing passenger from Australia, with particular focus on the increase in the PMC rate from 1 July 2012, and the implementation of a pilot compliance program;
- the self-assessment nature of customs duty and the complexity of the IT infrastructure facilitating the collection of duty and other border related revenue;
- the significant amount of customs duty and GST revenue collected; and



- progress in addressing the moderate audit findings in 2011–12 relating to the new human resources management information system (HRMIS).

5.51 In the light of these characteristics and the ANAO's understanding of the operations of Customs and Border Protection, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.52 Customs and Border Protection's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	1 054	1 049		
Revenue from government	951	935		
Administered income			9 407	7 901
Administered expenses			3	8
Total assets	821	799	188	177
Total liabilities	315	315	10	10

Customs and Border Protection's estimated average staffing level for 2012–13 is 5 120 (2011–12: 5 222).

## Governance arrangements

5.53 The agency has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of Customs and Border Protection's business objectives. These arrangements are designed to support Customs and Border Protection's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.54 The key elements of Customs and Border Protection's corporate governance arrangements include:

- a risk management framework that has a whole of agency focus and connects the strategic, operational and tactical levels of risk management;

- a strategic outlook document that considers the global context in which border management activities occur and evaluates the impact on border management developments;
- the preparation of an annual plan that directs the development of divisional and branch business plans. The plans identify major processes and risks which flow from the strategic outlook document described above;
- monthly executive meetings at which performance is evaluated, complemented by a bi-annual meeting of senior executives from central and regional offices to discuss strategic management issues and future directions;
- a Customs and Border Protection Practice Statement Framework which is used to define and implement the agency's national policies;
- an audit committee, with two independent members, that meets at least quarterly and focuses on internal audit and risk management issues;
- an internal audit function that has a planned risk based audit coverage of Customs and Border Protection's activities, including the management of IT systems; and
- a fraud control and corruption prevention framework which includes strategies for fraud and corruption preparedness, prevention, detection and resolution.

## **Areas of audit focus**

**5.55** In the light of the ANAO's understanding of Customs and Border Protection's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Customs and Border Protection's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the accuracy and completeness of PMC collections in view of the self assessment nature of the PMC and the increase in the charge levied from 1 July 2012;
- the accuracy and completeness of customs duty collections and refunds in light of the self-assessment nature of customs duty and the complexity of the related IT infrastructure;

- the progress in addressing the moderate audit findings in 2011–12 relating to the new HRMIS, including the management of defects and security management and access controls; and
- legislative compliance, particularly the implementation of measures designed to address the risk of a breach of section 83 of the Constitution, referred to in the 2011–12 financial statements.

**5.56** As an integral part of the interim audit phase, the ANAO reviews the IT general and application controls for key systems that support the preparation of Customs and Border Protection's financial statements.

### **Audit results**

**5.57** The ANAO's interim audit coverage to date has included a review of selected key controls over the collection of the PMC and customs duty. This included a review of the moderate issue from prior years relating to the compliance activity and management of the PMC. While progress has been made to address the issue, it remains outstanding at the time of the 2012–13 interim audit phase. The 2012–13 interim audit phase also included a review of Customs and Border Protection's progress in addressing the two moderate issues relating to the implementation of the HRMIS. The work undertaken identified that progress has been made in addressing the management of defects and security management and access controls. The progress in resolving these findings will be reviewed during the 2012–13 final audit phase. A review of Customs and Border Protection's measures to address the risk of a breach of section 83 of the Constitution has also been performed.

**5.58** To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

**5.59** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

## Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	1	(1)	0	0	0	0	0
B	3	(2)	2	3	0	0	3
L1	0	0	1*	1	(1)*	0	0
<b>Total</b>	<b>4</b>	<b>(3)</b>	<b>3</b>	<b>4</b>	<b>(1)</b>	<b>0</b>	<b>3</b>

\* The breaches in 2011–12 relate to section 83 of the Constitution. The finding is considered to be resolved on the basis that the risk of breaches in 2012–13 has been assessed as low.

### Resolved audit issues

Actual breaches of section 83 of the Constitution

**5.60** Customs and Border Protection's 2011–12 financial statements reported three breaches of section 83 of the Constitution totalling \$24 617 in relation to payments made under section 28 of the *Financial Management and Accountability Act 1997*. All amounts were subsequently recovered.

**5.61** Customs and Border Protection have implemented measures to address the risks associated with legislative compliance. These include:

- a review of Customs and Border Protection's delegation framework;
- the completion of a risk matrix to identify all specific legislative conditions under which payments can be made;
- the development of a questionnaire and reporting mechanism to capture instances of potential or actual non-compliance; and
- an education campaign for delegates.

**5.62** The implementation of Customs and Border Protection's framework to address the potential for breaches of section 83 of the Constitution has reduced the risk of non-compliance to low in 2012–13.

### Outstanding audit issues

Passenger Movement Charge (PMC)

**5.63** The PMC is a charge levied on each departing passenger from Australia. Customs and Border Protection estimate collections of \$794 million in 2012–13. The charge is applied and collected by airline carriers under the

*Passenger Movement Charge Act 1978* and the *Passenger Movement Collection Act 1978*.

**5.64** The 2009–10 interim audit identified a number of weaknesses in the management of the PMC, including that airline carrier compliance activity had not been undertaken in accordance with Customs and Border Protection's policies and procedures. In 2011–12, Customs and Border Protection employed an external consultant to develop a compliance program of carriers' activities. A pilot of the compliance program was undertaken in early 2012–13. At the time of the 2012–13 interim audit phase Customs and Border Protection was reviewing the results of the pilot. Once finalised, the compliance program will form part of Customs and Border Protection's operational activities.

HRMIS system management – management of defects

**5.65** Customs and Border Protection implemented a new HRMIS in June 2011 with a high number of defects and a significant number of processing and compensating administrative procedures. Customs and Border Protection is implementing processes to address the on-going management of defects, including the development of change and release management procedures and are continuing to resolve outstanding defects using a risk based approach. At the time of the 2012–13 interim audit phase, Customs and Border Protection advised that this audit issue would be finalised in June 2013.

HRMIS system management – security management and access controls

**5.66** During the 2011–12 interim audit phase, weaknesses were identified in the design and effectiveness of IT security management. Customs and Border Protection has progressively implemented system and process changes to address the issue. At the time of the 2012–13 interim audit phase, Customs and Border Protection advised that system and process changes were expected to be finalised in June 2013.

**5.67** The ANAO will review progress on the resolution of these issues during the final phase of the 2012–13 audit.

## **Conclusion**

**5.68** Based on audit coverage to date, the ANAO identified that, except for the abovementioned issues, key elements of internal control were operating effectively to provide reasonable assurance that Customs and Border Protection will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase. Additional audit procedures have been undertaken to address the risks arising from the audit issues referred to above.

# Broadband, Communications and the Digital Economy Portfolio

---

## Department of Broadband, Communications and the Digital Economy

**5.69** The Department of Broadband, Communications and the Digital Economy (DBCDE) works with industry, consumer groups and regulatory authorities to develop a sustainable and internationally competitive broadband, broadcasting and communications sector that promotes the digital economy for the benefit of all Australians. DBCDE provides strategic advice and support to the Australian Government on a wide range of significant and rapidly changing policy areas including broadband, the switch over to digital television, radio spectrum management and post and telecommunications.

**5.70** DBCDE's business operations include:

- facilitating the rollout and transition to fast, affordable and reliable broadband and communications infrastructure across Australia, including through the National Broadband Network;
- managing the transition to digital television by the end of 2013;
- supporting access to high-quality and diverse broadcasting services;
- spectrum management in relation to the relocation of commercial and national digital television services;
- promoting the benefits of the digital economy to all Australians and supporting safe and secure access;
- promoting an innovative, diverse and competitive communications market through effective regulation;
- improving services to regional, rural and remote Australia, including through the Satellite Phone Subsidy Scheme and the Indigenous Communications Program;
- supporting the development, application and innovative use of online technologies;
- supporting and protecting the interests of consumers through funding of the Australian Communications Consumer Action Network,

implementing measures to support the Government's Cybersafety Plan and measures relating to cybersecurity; and

- providing strategic policy advice on spectrum, telephone numbers and internet addresses.

5.71 The key characteristics of DBCDE's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- a legislative environment that is subject to ongoing change;
- significant administered activities including programs such as the Digital Television Switchover and the National Broadband Network;
- significant administered grants and subsidies expenses; and
- the reporting of significant administered assets relating to Australian Government investments in portfolio entities.

5.72 In the light of these characteristics and the ANAO's understanding of the operations of DBCDE, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.73 DBCDE's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	120	132		
Revenue from government	113	128		
Administered income			245	196
Administered expenses			1 586	1 860
Total assets	101	105	8 767	7 110
Total liabilities	38	40	27	72

DBCDE's estimated average staffing level for 2012–13 is 634 (2011–12: 668).



## Governance arrangements

5.74 DBCDE has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DBCDE's business objectives. These arrangements are designed to support DBCDE's financial reporting requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

5.75 The key elements of DBCDE's corporate governance arrangements include:

- an executive management group, chaired by the Secretary, that meets fortnightly and addresses strategic issues, monitors DBCDE's financial and non-financial performance, oversees the operational performance of divisions, and contributes to the development of DBCDE's policies and procedures;
- a performance reporting committee, chaired by the Secretary, that meets six times a year and oversees the risk management of each of DBCDE's major departmental programs and administered expense items;
- an audit committee that meets at least five times a year and has a focus on internal controls, internal and external audit activity, the management of risks, the review of financial reports, fraud control, and regulatory compliance;
- a financial statements sub-committee of the audit committee that meets at least four times a year and assists with the review of DBCDE's financial statements and other related financial matters as requested by the audit committee;
- an internal audit function that undertakes risk-based audit coverage of DBCDE's activities;
- fraud control and risk management plans that are regularly monitored and updated; and
- an annual Certificate of Compliance regime which forms a key part of DBCDE's corporate governance and compliance framework.

## **Areas of audit focus**

5.76 In the light of the ANAO's understanding of DBCDE's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DBCDE's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the valuation of administered investments, particularly the significant investments in Australian Government portfolio entities;
- the valuation of the assets related to the Regional Backbone Blackspots Program, reflected as an administered asset in DBCDE's financial statements;
- presentation and disclosure of large administered contingent liabilities and commitments associated with the National Broadband program; and
- administered grants and subsidies expenses which represent a significant portion of total administered expenses.

5.77 As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DBCDE's financial statements.

## **Audit results**

5.78 The ANAO has completed its interim audit coverage to assess the effectiveness of internal controls in areas which had been identified as having a potential impact on the financial statements, including administered grants and subsidies.

5.79 The remaining areas of audit focus will be completed as part of the 2012–13 final audit phase.

5.80 To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

5.81 The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

**Status of audit issues raised by the ANAO**

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	1	1	(1)	0	0
L1	0	0	0	0	0	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>

*Resolved audit issue*

User access controls

**5.82** In 2011–12, the ANAO identified one moderate issue in relation to user access to DBCDE’s network after the termination of employment. The ANAO’s review of DBCDE’s termination process identified that there were three users who accessed DBCDE’s network after their employment was terminated. The reasons for access to the network were not able to be established. Unauthorised system access increases the risk of data leakage and a risk of inappropriate use of DBCDE’s systems. During the 2012–13 interim audit phase, the ANAO confirmed that DBCDE had implemented appropriate controls and processes to address this issue.

**Conclusion**

**5.83** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DBCDE will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Defence Portfolio

---

## Department of Defence

**5.84** The primary objective of the Department of Defence (Defence) is to protect and advance Australia's strategic interests by providing military forces for the direct defence of Australia and its unique strategic interests. To meet this objective, Defence prepares for and conducts military operations and other tasks directed by the Government.

**5.85** Defence's business operations include:

- maintaining the capacity to support current commitments and provide response options to the Government to meet the range of potential future security contingencies, including working collaboratively with Australia's neighbours and the broader international defence community, and contributing to coalition operations in support of Australia's national interests;
- undertaking a range of military operations at the Government's direction to ensure the defence of Australia and its national interests. The Australian Defence Force's military operations and other tasks contribute to the achievement of the Government's strategic objectives, contributing to the security of the immediate neighbourhood and supporting wider interests; and
- providing emergency and non-emergency assistance to the Government and the Australian community in non-combat related roles. These responsibilities may include emergency assistance, search and rescue, disaster recovery, surveillance, security or non-emergency law enforcement roles, and be directed by the Government or requested by other civil authorities, government departments or agencies.

**5.86** The key characteristics of Defence's business operations that shaped the ANAO's 2012–13 planned financial statements audit coverage include:

- a multifaceted and diversified business structure that has a significant geographical spread both nationally and overseas, and is governed by an operational tempo that requires the capability to deploy resources efficiently;

- the magnitude, complexity and dispersed nature of Defence's operations which comprise inventory and asset management, storage and distribution, significant property estate management, technology research and development and project management in specialised fields such as warfare;
- domestic and international developments, such as, the downsizing of Defence spending and its affect on the military supply chain; the operational drawdown from the Solomon Islands, East Timor and Afghanistan; and the pressure on Defence to deliver targeted budget outcomes in a tighter fiscal environment;
- the complex arrangements between Defence and the Defence Materiel Organisation (DMO) in relation to the maintenance, acquisition, construction, and modification of equipment and systems;
- changing business and control processes, including changes in accountability and responsibility, and shared services arrangements; and
- the risks associated with the aggregation of financial reporting information due to the variety of information technology systems that operate independently of each other, together with the significant estimation required for the calculation of a number of balances.

5.87 In the light of these characteristics and the ANAO's understanding of the operations of Defence, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as high.

## Financial overview

5.88 Defence's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	22 787	23 025		
Revenue from government	22 895	22 466		
Administered income			1 380	1 316
Administered expenses			5 948	4 216
Total assets	71 369	70 631	2 910	3 019
Total liabilities	5 570	5 474	49 128	85 795

Defence's estimated average staffing level for 2012–13 is 92 822: 56 711 permanent forces, 19 967 reservists, 15 794 APS staff and 350 professional services staff. (2011–12: 95 463: 57 882 permanent forces, 21 250 reservists, 15 848 APS staff and 483 professional services staff).

## Governance arrangements

5.89 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of Defence's business objectives. These arrangements are designed to support Defence's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.90 The key elements of Defence's corporate governance arrangements include:

- a unique structure that reflects individual responsibilities and accountabilities of the Secretary and the Chief of the Defence Force (CDF) for joint delivery of Defence's outcomes. Under this structure the Secretary and Chief of the Defence Force are guided by a joint Ministerial directive detailing the expectations of the Minister;
- the Defence Committee, chaired by the Secretary, is the pre-eminent committee. This committee meets on a monthly basis and considers the most significant Defence enterprise policy and management issues and sets Defence's performance outcomes through an enterprise management framework, including the annual planning process;
- the Secretary and CDF Advisory Committee (SCAC) is the pre-eminent direction setting and decision-making committee for the week-to-week

management of the department. The standing members of the SCAC are the Secretary and the CDF who jointly chair the committee. All other participants at SCAC meetings are co-opted as required by the Chairs;

- the Chiefs of Service Committee, which is chaired by the CDF, provides military advice to assist the CDF to discharge his responsibilities in command of the Defence Force and as principal military adviser to the Government;
- a governance committee framework, including the Defence Audit and Risk Committee (DARC), the Defence Capability and Investment Committee, and the Service Delivery Reform Committee;
- a fraud control framework that includes a fraud control plan, which is the responsibility of the Inspector General within the internal audit branch. Divisional fraud control officers are responsible for implementing the FCP, and the fraud investigation branch assess and investigate allegations of fraud; and
- an internal audit function, which performs a range of internal audits across Defence and DMO (a major provider of goods and services to Defence) and reports findings to the DARC and the Defence Executive.

## Areas of audit focus

**5.91** In the light of the ANAO's understanding of Defence's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Defence's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- internal control mechanisms which may be affected by budgetary pressures and changes stemming from the Defence shared services program, in particular, the realignment of control and assurance processes relating to financial services across Defence's business groups and DMO;
- inventory and asset management due to the material nature of the inventory and asset balances and issues noted in prior years. These issues relate to errors in the recording of the underlying financial transactions that require sustained remediation by Defence and result

in the need for continuing adjustments to the inventory and asset balances;

- the valuation and classification of specialist military equipment (SME). These assets are a material asset balance and the assessment of asset values involves a high level of judgement and technical expertise. The valuation of SME assets also involves the accurate and complete recording of operational and capitalised expenditure associated with specialist military assets under construction (AUC). The financial and operational management of AUC is dispersed across a wide variety of projects that have complex contractual arrangements and project management requirements; and
- legislative compliance, particularly focusing on Special Appropriations and Special Accounts which are governed by complex reporting requirements.

**5.92** In addition, the ANAO will continue to undertake audit coverage in areas previously identified as significant to the financial statements including:

- the complex estimations involved in calculating a number of balances in Defence's financial statements, including provisions for decommissioning of SME, military superannuation, and decontamination and restoration in relation to a large number of Defence sites both nationally and overseas;
- the calculation and reporting of commitments and contingencies that are complex and highly dependent on devolved management activities across Defence and DMO;
- management of explosive ordnance, due to the sensitive and material nature of these assets;
- general asset purchases and capital works which are high in volume and have previously required adjustments. These assets are geographically dispersed, subject to large variations in value and require the engagement of a valuation expert;
- finance leases due to increases resulting from completion of the construction of live-in residential units located on Defence military bases;
- IT general and application controls for key systems that support the preparation of Defence's financial statements; and



- Defence's management of complex and diversified human resource management systems.

## **Audit results**

**5.93** The ANAO 2012–13 interim audit coverage included Defence's purchasing expenditure, general assets management, cash management, IT general controls and specific application controls testing for key financial and business systems.

**5.94** The ANAO's review of the operation and remediation activities associated with the Military Integrated Logistics Information System (MILIS), included the effectiveness of the maturing governance arrangements, change management controls and the resolution of MILIS specific defects. The ANAO's review noted improvements in MILIS change management and project governance and, as a result, the two moderate audit issues reported previously have been resolved.

**5.95** In addition, one previously reported moderate audit issue related to business continuity management has been resolved. The ANAO also downgraded one moderate issue concerning administrator access to the financial management information system ROMAN to a category C issue based on corrective action undertaken by Defence in 2012–13.

**5.96** Three new moderate audit issues were identified in relation to: general assets data quality; the implementation of policy requirements relating to the review of general asset values; and deficiencies in the preparation of Defence's fraud control plan.

**5.97** The remaining areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.98** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

## Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	13	(7)	4	10	(4)*	3	9
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>13</b>	<b>(7)</b>	<b>5</b>	<b>11</b>	<b>(4)</b>	<b>3</b>	<b>10</b>

\* One moderate audit issue relating to administrator user access to the FMIS was downgraded to a category C finding.

### *Resolved audit issues*

#### Military integrated logistics information system (MILIS)

**5.99** The Military Integrated Logistics Information System (MILIS) underpins Defence’s logistics support to operations and supports the financial reporting of inventory and asset balances. The ANAO’s review of the implementation of MILIS in 2010–11 resulted in the ANAO reporting a number of significant and moderate audit issues. At the conclusion of the 2011–12 audit, the ANAO reported that three moderate audit issues relating to MILIS remained outstanding. These related to project governance, change management and data quality, and were the focus of ongoing remediation activity under the MILIS Inventory Assurance Program (MIAP) and continue to be a focus under the MILIS Implementation and Performance Improvement Program (MPIP), which commenced in 2011– 2012.

**5.100** The issue related to MILIS project governance was initially reported as a significant audit issue in 2010–11 and was subsequently downgraded to a moderate audit issue during the 2011–12 audit. The establishment of governance and accountability lines and the introduction of independent assurance processes contributed to this downgrading. The outstanding component related to the certification that MILIS had Final Operating Capability. This occurred in November 2012 and, as a result, this audit issue has been resolved.

**5.101** The moderate audit issue relating to MILIS change management has also been resolved during the interim phase of the 2012–13 audit. The processes and controls implemented for managing the authorisation, testing and migration of MILIS system changes, including the monitoring of system

changes throughout their lifecycle, were assessed by the ANAO as operating effectively.

#### Business continuity management

**5.102** In 2009–10, the ANAO reported a moderate audit issue in relation to business continuity management including:

- incomplete group level Business Impact Analysis (BIA); and
- business continuity planning requirements that remained uncompleted.

**5.103** These plans are designed to provide assurance that Defence has adequate recovery mechanisms in the event of a major failure or disaster and to ensure that critical business functions remain operational.

**5.104** The ANAO's review of progress in this area during the 2012–13 interim audit phase identified that Defence had finalised the BIA and business continuity plan requirements. Defence continues to improve its continuity arrangements, including the testing of these plans. As a result of the above activities, the audit issue relating to business continuity planning has been resolved.

#### Financial management information system (ROMAN)

**5.105** During the final phase of the 2011–12 audit, the ANAO's review of the management of privileged user access to Defence's financial management information system, ROMAN, identified inadequate segregation of duties between administrator functions and financial transaction processing. The segregation of these functions reduces the risk that inappropriate or unauthorised financial transactions are processed. In response to the audit finding, for specific users, Defence removed their ROMAN system administration access.

**5.106** While the ANAO's review identified that the issues previously reported had been addressed, a breakdown in controls following the corrective action taken by Defence resulted in a user having access to the complete suite of ROMAN business functions. The access was supported by a business requirement and was appropriately approved; however it was not removed at the end of the relevant period. Once identified, the access was removed and Defence advised that it was taking action to confirm whether any unauthorised transactions were processed while the access remained active. The moderate audit issue related to administrator access has been downgraded to a minor audit issue pending the outcome of the action being taken by Defence.

## *Outstanding audit issues*

### Internal control and financial reporting

**5.107** In 2011–12, a moderate audit issue was reported relating to assets that had been expensed in previous periods but were later identified as assets that should have been capitalised. The incorrect accounting treatment resulted in a misstatement of gains in the income statement, which was adjusted by Defence prior to the finalisation of the 2011–12 financial statements. Defence has advised that the accounting for these assets will be centralised in the Chief Finance Officer’s group with a quarterly review undertaken to determine whether any incorrect accounting treatments require adjustment. Defence has advised that the reviews of the first two quarters have occurred. The ANAO will review the effectiveness of this process as part of the 2012–13 final audit phase.

**5.108** In 2011–12, the ANAO identified a moderate audit issue relating to amounts deposited into a special account that, if paid from the account, were likely to result in a legislative breach. Defence has subsequently transferred the amounts at risk out of the special account and completed an analysis of the remaining funds within the account, with no further issues identified. The ANAO will review special account transactions as part of the 2012–13 final audit phase.

### Royal Australian Navy ship inventory and asset management

**5.109** Two moderate audit issues relating to inventory and assets management carried forward from prior years remain outstanding. These relate to the need to improve IT and business processes that support the timely and accurate processing of inventory returns, and improving the retention of documentation evidencing the approval of the disposal of certain Defence assets. In 2012–13, Defence advised that the processes for both inventory returns and disposal approvals have been reviewed and the backlog of inventory returns reduced. The ANAO will review the effectiveness of the new processes implemented as part of the 2012–13 final audit phase.

### Military Integrated Logistics Information System (MILIS)

**5.110** The moderate audit issue relating to the quality of MILIS data remains outstanding as system defects continue to adversely affect data quality during 2012–13. The ANAO places reliance on the remediation activities performed by Defence, in particular, the work performed by the Data Quality Working Group. This group analyses system defects, assesses the financial transactions

effected and processes adjustments to the financial statements at year end for the financial affect of any defects. These assurance activities are important in ensuring that the MILIS system defects do not result in a material misstatement of the inventory and assets balance at year end.

#### Asset management

**5.111** A moderate audit issue was reported in 2011–12 that referred to the inaccurate and incomplete transfer of information between the valuation reports received by Defence from valuation specialists and the fixed asset register. Defence subsequently adjusted the asset register to reflect the correct valuation amounts.

**5.112** Defence has advised that its asset valuation processes and procedures have been updated to include a reconciliation between independent expert's valuation reports and the values included in the fixed assets register. In addition, quality assurance processes to detect any anomalies will be implemented. The ANAO will review the effectiveness of these newly implemented processes as part of the 2012–13 final audit phase.

#### *New moderate audit issues*

**5.113** Three new moderate audit issues were identified during the interim phase of the 2012–13 audit relating to deficiencies in Defence's Fraud Control Plan, and accounting for general assets.

#### Internal control and financial reporting

**5.114** Section 45 of the *Financial Management and Accountability Act* (FMA Act) provides that a Chief Executive must implement an agency Fraud Control Plan (FCP). The 2011 Commonwealth Fraud Control Guidelines (CFCGs) establishes the Commonwealth's fraud control policy framework, through which Chief Executives can discharge this requirement. Critical to the development of a robust FCP is an integrated risk assessment process which considers fraud risk factors at a number of levels, including at the operational process level.

**5.115** The ANAO's review of the current Defence FCP identified a number of deficiencies, when compared to the policy framework. These included:

- the approach for controlling key fraud and corruption exposures at the operational level not being documented in the FCP; and
- an absence of procedures for updating the FCP for emerging risks and identified control weaknesses or fraud.

## Assets management

**5.116** Australian Accounting Standards require agencies to assess annually whether there is any indication that assets may be impaired. Factors to be taken into account include their condition and use by the entity. The ANAO identified a moderate audit issue in relation to the application of this requirement including:

- assets where their condition was not considered; and
- asset values reported in the fixed asset register that had not been adjusted for known poor condition or discontinued use.

**5.117** In addition, Defence accounting policy requires the annual assessment to be undertaken of assets with a written down value of greater than \$50 000. While the setting of a threshold for review is accepted management practice, the total asset balance for these assets should be periodically reviewed to ensure that the total value of the class of assets has been assessed for impairment. The ANAO identified that the total value of assets under the above-threshold is more than \$600 million and has not been subject to an annual impairment assessment. Defence guidance requires assets below \$50,000 to be assessed when information becomes available indicating that an asset may be impaired. There was no evidence that during 2012–13 this had been occurring. This situation has the potential to result in the asset balance being materially misstated.

**5.118** The ANAO also identified a moderate audit issue relating to the integrity of data contained within the ROMAN asset register. The issues identified include:

- unclear or inaccurate asset descriptions and location details;
- incorrect asset classifications;
- the removal from the ROMAN asset register of assets no longer held not being undertaken in a timely manner; and
- a large number of discrepancies between the ROMAN asset register, which is used for financial reporting, and the information technology (IT) information system (TAMIT) which is used for the management of IT assets.

**5.119** Data within the ROMAN asset register is used for stocktaking and asset revaluation purposes. These stocktaking and asset valuation exercises, together

with the asset register listing, underpin the asset balance reported in the financial statements. The issues identified by the ANAO increase the risk that the asset balance reported in the financial statements is materially misstated.

### *Potential breaches of section 83 of the Constitution*

**5.120** The notes to Defence's 2010–11 and 2011–12 financial statements referred to potential breaches of section 83 of the Constitution for payments made from special appropriations and special accounts, particularly in circumstances where the payments do not accord with conditions included in the relevant legislation.

**5.121** The 2011–12 auditor's report included a report on other legal and regulatory requirements referring to potential breaches as identified by Defence. A total of 919 potential breaches of section 83 totalling \$5.55 million were identified. Legislative amendments passed in late June 2012 lowered the risk of certain future payments being made in breach of section 83. The remaining risk is being mitigated through system and procedural changes.

**5.122** During 2012–13, the risk of payments from other special appropriations being in breach of section 83 was assessed by Defence as low.

**5.123** Defence has undertaken to continue to monitor its level of section 83 compliance across all legislation for which it is administratively responsible. Defence has advised that, where possible, amendments to legislation and future changes to procedures will continue to be progressed.

**5.124** This matter will be reviewed as part of the final phase of the 2012–13 audit.

## **Conclusion**

**5.125** Based on audit coverage to date, the ANAO identified that, except for the abovementioned issues, key elements of internal control were operating effectively to provide reasonable assurance that Defence will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase. Additional audit procedures have been undertaken to address the risks arising from the audit issues referred to above.

## **Defence Materiel Organisation**

**5.126** The Defence Materiel Organisation (DMO) is the primary service delivery agency responsible for the effective support of Australian Defence

Force operations through the acquisition of equipment and supplies, sustainment of the Australian Defence Force, and the deployment of specialist staff. The DMO also provides industry and procurement policy and advice to the Department of Defence (Defence) and the Australian Government.

**5.127** The DMO employs over 7 200 staff and contractors in over 70 locations within Australia and overseas. It budgets for a break even operating result that reflects the DMO's funding model whereby it is funded for the activities performed. These activities are principally determined by objectives set by the Australian Government, Defence policies and the operational requirements of the Australian Defence Force.

**5.128** The DMO receives the majority of its funding from Defence, operating under a number of purchase-provider arrangements. The funding arrangements are formalised in agreements covering key operational areas including acquisition, sustainment, military workforce and shared services. DMO also receives an appropriation for its workforce and operating expenses.

**5.129** Expenditure for acquisition activities is expected to decrease from \$4 584 million in 2011–12 to \$3 618 million in 2012–13, and sustainment activities are expected to decrease from \$5 389 million to \$5 165 million.

**5.130** The key characteristics of DMO's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- domestic and international developments, such as, the global downsizing of Defence spending and its affect on the military supply chain; and the DMO's ability to deliver targeted budget outcomes in a tighter fiscal environment;
- a number of significant financial statement balances and a complex financial statements process that involves collating data from numerous business systems and processes in a number of locations nationally;
- DMO's diversified corporate and project management IT applications that operate in a number of locations nationally and overseas;
- the number of financial and human resource business processes that are managed by Defence and are utilised by DMO;
- changes to the design and operation of controls for the approval and monitoring of capital acquisition projects on behalf of Defence, including an increase in project oversight and assurance activities by



capability managers and the major capital acquisition project gate review process;

- changes to sustainment activities, in particular, new contractual arrangements and processes to achieve delivery of lower cost outputs;
- new accountability arrangements between Defence and DMO directed towards improving procurement and delivery outcomes; and
- changes to the accountability and operations of financial processes and related controls, resulting from the implementation of the Defence shared services program.

**5.131** In the light of these characteristics and the ANAO's understanding of the operations of DMO, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

**5.132** DMO's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	911	884		
Revenue from government	911	931		
Administered income			0	1
Administered expenses			0	1
Total assets	1 919	2 082	0	4
Total liabilities	1 549	1 712	0	0

DMO's estimated average staffing level for 2012–13 is 7 220 (2011–12: 7 434).

## Governance arrangements

5.133 DMO has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DMO's business objectives. These arrangements are designed to support DMO's financial reporting requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

5.134 The key elements of DMO's corporate governance arrangements include:

- the establishment of an Executive Committee, chaired by the Chief Executive, to oversight decision making and strategic direction of DMO. The Executive Committee meets monthly.
- a Materiel Audit and Risk Committee (MARC). The MARC is comprised of four independent members and formally meets up to eight times per year. The MARC works in conjunction with the Defence Audit and Risk Committee (DARC) to oversee matters of shared importance to DMO and Defence. The Chair of the MARC attends the DARC's meetings as an observer;
- an internal audit function that is responsible for providing an independent, objective and systematic evaluation of risk management, the control framework, compliance and governance within DMO. Individual internal audit activities are mainly delivered by external providers in accordance with a program that is managed by the Chief Audit Executive;
- a Projects of Concern Unit that monitors projects that encounter significant and unanticipated issues. The unit is responsible for devising strategies to address the issues, to examine and report on performance remediation and advise the CEO and Government;
- regular management reports to the CEO that detail the status of the delivery of Defence acquisition and sustainment activities. These reports are also provided to Defence and central agencies;
- a fraud control plan that aligns with the Commonwealth Fraud Control Guidelines; and

- a range of boards that monitor and report on key areas of accountability within DMO, including:
  - Gate Review Assurance Boards for all major capital acquisition projects that conduct formal project reviews for selected key project milestones with the aim of assuring a project's status and prospects of achieving the capability required; and
  - Project Manager Stakeholder Groups that regularly review the status and progress of major acquisition projects.

### **Areas of audit focus**

**5.135** In the light of the ANAO's understanding of DMO's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DMO's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the accounting for, and recording of, cost of goods sold and repairs and overhaul expenses, which involves a high number of transactions and a significant level of complexity in terms of contractual arrangements and project management requirements, given the wide variety of agreements involved;
- the accounting for, and disclosure of, prepayments which are complex in nature and subject to both material fluctuations as projects and contracts change and increase the risk of inaccurate and incomplete aggregation due to the decentralised manual recording process from which they are derived;
- the accounting for, and the reporting of, monies owed by Defence to DMO and unearned income, which comprises complex manual calculations and compilation;
- IT general and application controls for key systems that support the preparation of DMO's financial statements; and
- the aggregation of financial information from different operational areas, systems and processes. This includes financial statements disclosures that involve aggregation of data and information from several sources.

## Audit results

5.136 The ANAO's 2012–13 interim audit phase has focused on DMO's control environment and has included site visits to a number of system program offices to confirm if controls in regional areas are operating effectively.

5.137 The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

5.138 To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

5.139 The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	1	0	1	2	0	0	2
L1	0	0	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>0</b>	<b>0</b>	<b>2</b>

### Outstanding audit issues

#### Bureau service arrangements between Defence and DMO

5.140 Defence manages a number of IT systems and business processes on behalf of DMO. These systems and processes form an integral part of DMO's internal control framework to support the preparation of its financial statements.

5.141 DMO obtains assurance over the integrity of transactions processed by the systems managed by Defence, and the effectiveness of manual controls supporting these processes, as these transactions are included in the balances reported in DMO's financial statements. However, existing arrangements between Defence and DMO do not provide mechanisms that assist DMO to obtain the necessary assurance from Defence over the effectiveness of key IT application and general controls over financial reporting systems.

**5.142** The ANAO has previously reported that existing shared service agreements, or other formal agreements, should include control and monitoring activities that allow DMO to obtain the necessary assurance from Defence over the effectiveness and adequacy of controls in the areas referred to above.

**5.143** In June 2012, DMO provided the ANAO with a paper discussing, at a broad level, the management assurance controls DMO considers are in operation. The ANAO considers that this information should be supported by a risk assessment, by financial account balance, mapped to specific assurance controls in relation to the financial transactions processed by Defence.

**5.144** Pending the receipt of this risk and control assessment, the ANAO has increased its audit coverage to assist in obtaining adequate assurance over the financial transactions processed by Defence.

**5.145** The ANAO will assess DMO's response and report the status of the issue at the completion of the 2012–13 final audit phase.

#### Financial reporting of appropriations and cash management

**5.146** During the 2011–12 audit, the ANAO identified a number of reporting and disclosure issues relating to:

- the lack of reconciliation between the Department of Finance and Deregulation's (Finance) central budget and management system (CBMS) and DMO's financial management information system (ROMAN);
- delays in updating ROMAN to reflect appropriation reductions and CBMS processing errors identified by DMO's treasury reporting team;
- the inability to provide signed documentation supporting drawing rights; and
- the incorrect application of Finance's advice regarding the treatment of electronic funds payments to suppliers and drawdown amounts from the Consolidated Revenue Fund.

**5.147** These issues had the potential to increase the risk of a legislative breach and incorrect financial statement disclosures of DMO's special account, cash and the supplier payable balances.

**5.148** In 2012–13, DMO advised that the reconciliation controls between CBMS and ROMAN and financial reporting procedures for appropriations had

been strengthened. The ANAO will review the actions taken by DMO during the 2012–13 final audit phase.

## **Conclusion**

**5.149** Based on audit coverage to date, the ANAO identified that, except for the abovementioned issues, key elements of internal control were operating effectively to provide reasonable assurance that DMO will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase. Additional audit procedures have been undertaken to address the risks arising from the audit issues referred to above.

## **Department of Veterans' Affairs**

**5.150** The Department of Veterans' Affairs (DVA) is the primary service delivery agency responsible for developing and implementing programs that assist the veteran and defence force communities. DVA also provides administrative support to the Repatriation Commission and the Military Rehabilitation and Compensation Commission.

**5.151** DVA's business operations include:

- maintaining and enhancing the financial wellbeing and self-sufficiency of eligible persons and their dependants through access to income support, compensation, and other support services, including advice and information about entitlements;
- maintaining and enhancing the physical wellbeing and quality of life of eligible persons and their dependants through health and other care services that promote early intervention, prevention and treatment, including advice and information about health service entitlements; and
- acknowledging and commemorating those who served Australia and its allies in wars, conflicts and peace operations through promoting recognition of service and sacrifice, preservation of Australia's wartime heritage, and official commemorations.

**5.152** The key characteristics of DVA's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- a legislative environment incorporating complex rules for the provision of benefits to veterans and defence personnel;
- the diverse range of entitlements administered by DVA, and the reliance placed on voluntary disclosure of information by recipients;
- a complex IT environment, including a number of legacy systems used to process on a regular basis a significant number of high volume, low value transactions; and
- extensive contractual arrangements with service providers, institutions, and State and Territory Governments.

**5.153** In the light of these characteristics and the ANAO's understanding of the operations of DVA, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

**5.154** DVA's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	309	327		
Revenue from government	285	296		
Administered income			9	7
Administered expenses			12 221	13 722
Total assets	227	228	1 368	1 357
Total liabilities	142	140	5 752	5 529

DVA's estimated average staffing level for 2012–13 is 1 928 (2011–12: 1 987).

## Governance arrangements

**5.155** The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DVA's business objectives. These arrangements are designed to support DVA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.156** The key elements of DVA's corporate governance arrangements include:

- a corporate plan that sets out DVA's focus and direction as well as the risks and challenges facing DVA. In order to assess progress against the priorities identified in the corporate plan, DVA has a monthly reporting process, which includes financial, operational and strategic analysis;
- an executive management group that meets monthly to determine and evaluate progress on the agreed strategic directions of DVA. The group is supported by sub-committees that assess the overall performance of DVA's operations through a variety of reporting mechanisms;
- a financial reporting framework that involves monitoring the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports;
- an information and communication technology strategic plan aimed at developing the future DVA business model and programs and corresponding IT requirements;
- a governance committee framework, including an audit and risk committee that provides independent assurance and assistance in relation to all matters relating to risk management, the control and compliance framework and external accountability. The committee also has a monitoring role in relation to the progress of internal audit and the financial statements preparation process;
- an internal audit function that develops an internal audit strategy, undertakes risk profiling across DVA and conducts an internal audit program that addresses business and financial risks;
- a fraud risk assessment every two years and a framework for incorporating risk management into DVA's broader management and business processes; and
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and the Secretary's annual Certificate of Compliance.



## Areas of audit focus

**5.157** In the light of the ANAO's understanding of DVA's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DVA's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the significant amount of high volume, low value transactions being processed on a regular basis by complex and ageing information systems;
- the quality assurance framework over payments for income support and rehabilitation and compensation for veterans and their dependants;
- the complexity of assumptions and calculations underpinning the actuarial assessment of the military compensation provision;
- IT general and application controls as they relate to the financial statements; and
- legislative compliance, particularly the implementation of measures designed to address the risk of a breach of section 83 of the Constitution, referred to in the 2011–12 financial statements.

**5.158** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DVA's financial statements.

## Audit results

**5.159** During 2011–12, the ANAO reported a number of issues relating to DVA's quality assurance framework. This framework consists of a number of individual QA programs. Two programs, the Income Support and the Rehabilitation and Compensation programs, are designed to provide a necessary level of assurance relating to veterans' income, widow/ers and disability support expenses of \$6.4 billion and military compensation expenses of \$2.0 billion respectively as reported in the 2011–12 financial statements. At the date of this report, key remediation actions have not been completed in accordance with the timeframes set by DVA in response to the ANAO's findings.

**5.160** At the date of this report, DVA was in the process of identifying alternative assurance mechanisms for financial reporting purposes, which will

involve validation of the effectiveness of controls over material administered expenditures. The result of this exercise is intended to provide the necessary assurance of the completeness and accuracy of administered items that have estimated expenditures of \$12.2 billion and liabilities of \$5.8 billion in 2012–13. This work is planned to be completed in June and July 2013.

**5.161** The implementation of these alternative assurance mechanisms is important to the successful preparation of the 2012–13 financial statements. As the alternative assurance plan timetable has been delayed, the ANAO has revised its 2012–13 audit strategy and will now review this work as part of the 2012–13 final audit phase.

**5.162** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

**Status of audit issues raised by the ANAO**

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	6	(1)	0	5	(1)	0	4
L1	0	0	2	2	0	0	2
<b>Total</b>	<b>6</b>	<b>(1)</b>	<b>2</b>	<b>7</b>	<b>(1)</b>	<b>0</b>	<b>6</b>

*Resolved audit issues*

Treatment account system

**5.163** During the 2011–12 audit, the ANAO identified that the treatment account system used by the Department of Human Services (DHS) on behalf of DVA to process medical, hospital and allied health services claims, had not been configured to enforce the agreed fees with private hospitals for online claims.

**5.164** In response to this issue, DVA advised that all payments are now subject to manual assessment. The ANAO has confirmed this approach appropriately addressed the issue. As a result, this issue is resolved.

## *Outstanding audit issues*

### Quality assurance framework

**5.165** DVA has a quality assurance (QA) framework that is designed to provide assurance over the correctness of administrative decisions, the achievement of program and policy outcomes, and the completeness and accuracy of financial statement reporting.

**5.166** As indicated in paragraph 5.159 above, during the 2011–12 audit, a number of weaknesses were identified in the QA framework relating to the Income Support and Rehabilitation and Compensation QA programs. In particular, the audit identified a lack of financial quantification of identified errors, inadequate segregation of duties within the IT application used for quality assurance, a lack of an audit trail for actions completed within this application, inadequate documentation of completed procedures, and the existence of errors not previously identified by the department.

**5.167** The ANAO's review of the IT application (QUASARS) used in selecting samples of decisions and payments for quality assurance review and the reporting of quality assurance activities in DVA, also identified a large number of users with privileged access, without the logging and monitoring of actions performed by users within the system. This access included the ability to amend underlying data, sample selections, and quality assurance results.

**5.168** To address the above issues, DVA proposed a range of remediation measures which are in various stages of implementation, with finalisation expected in early 2013–14.

### Management of user access

**5.169** The 2011–12 audit identified a significant number of users that had user access which resulted in inadequate segregation of duties within key payment systems. In addition, there was no monitoring of user access. While DVA subsequently established a number of controls seeking to address the resulting risks of providing extensive user access, the ANAO identified that these did not adequately address the risks involved. The 2011–12 audit concluded that this situation significantly increased the risk of incorrect payments being made through these systems.

**5.170** The 2011–12 audit also identified that a number of the users with inadequate segregation of duties within key payment systems, also held privileged user access to DVA's QA IT application (QUASARS).

**5.171** The 2011–12 audit concluded that while DVA had reduced the number of users with privileged access to QUASARS, remediation of the remaining issues was being progressively implemented.

**5.172** During 2012–13, DVA has continued to reduce the access that previously resulted in inadequate segregation of duties within key payment systems. However, the monitoring of access has not been adequately addressed and, as a result, the issue remains outstanding.

#### Reconciliations

**5.173** During the 2011–12 audit, the ANAO continued to identify that reconciliations between the general ledger and subsidiary systems for payroll, accounts receivable, and accounts payable, were not always completed and reviewed in a timely manner, with some variances remaining unresolved for significant periods of time. Similar observations were made during the 2009–10 and 2010–11 audits in relation to payroll reconciliations. In addition, there were instances of a lack of evidence that appropriate reconciliations had been performed and reviewed for one bank account.

**5.174** Overall, these weaknesses increased the risk that financial transactions were not accurately recorded and reported.

**5.175** While the 2011–12 audit identified some improvement compared to previous years, further improvement was required. The ANAO will review this issue during the 2012–13 final audit phase.

#### Provision for payments to hospitals

**5.176** DVA has agreements with states and territories for health care services that are provided by hospitals to veterans. DVA recognises a liability for outstanding eligible hospital payments. During the 2009–10, 2010–11 and 2011–12 audits, weaknesses were identified in the quality and availability of data used to estimate this provision at year end.

**5.177** DVA advised it will continue to work closely with state and territory governments to improve the quality and availability of data for the estimation of this provision. This matter will be reviewed as part of the final phase of the 2012–13 audit.

### *Legislative breaches*

#### Management of waivers

**5.178** During the 2010–11 audit, the ANAO identified several instances where debts had been waived under provisions of the *Veterans' Entitlements Act 1986*

(VE Act) without a Determination by the Repatriation Commission. The VE Act requires all waivers to have such a Determination, which serves as a control for the waiving of debts.

**5.179** In 2011–12 and 2012–13, DVA implemented a range of remedial measures, including issuing further advice to relevant staff, and subsequent reviews to ascertain the level of compliance with the VE Act. However, the ANAO identified that these measures had not been effective in addressing the issue. This was due, for example, to waivers not being authorised by an appropriate delegate or not being supported by complete documentation. DVA have advised that a detailed project plan will be developed to resolve this issue.

**5.180** This matter will be further reviewed as part of the final phase of the 2012–13 audit.

#### *Potential breaches of section 83 of the Constitution*

**5.181** The notes to DVA's 2010–11 and 2011–12 financial statements referred to potential breaches of section 83 of the Constitution for payments made from special appropriations and special accounts, particularly in circumstances where the payments do not accord with conditions included in the relevant legislation.

**5.182** The 2011–12 auditor's report included a report on other legal and regulatory requirements referring to these potential breaches.

**5.183** DVA has undertaken to continue to monitor its section 83 compliance across all legislation for which it is administratively responsible. Where possible, future changes to procedures and amendments to legislation will continue to be progressed.

**5.184** This matter will be reviewed as part of the final phase of the 2012–13 audit.

## **Conclusion**

**5.185** In view of the above matters, particularly those outlined at paragraphs 5.159 to 5.161, there has been some delay in progressing the 2012–13 interim audit phase. The outstanding work will be completed in conjunction with the 2012–13 final audit phase.

# Education, Employment and Workplace Relations Portfolio

---

## Department of Education, Employment and Workplace Relations

**5.186** The Department of Education, Employment and Workplace Relations (DEEWR) provides policy advice and administers programs to achieve the Government's objectives in the areas of education, employment and workplace relations.

**5.187** DEEWR's business operations include:

- improving access to quality services that support early childhood learning and care for children through a national quality framework; agreed national standards; investment in infrastructure; and support for parents, carers, services and the workforce;
- the improvement of learning and literacy, numeracy and educational attainment for school students, through funding for quality teaching and learning environments, workplace learning and career advice;
- the enhancement of employability, and acquisition of labour market skills, and knowledge and participation in society through direct financial support and funding of employment and training services; and
- the provision of safer, fairer and more productive workplaces for employers and employees by promoting and supporting the adoption of fair and flexible workplace arrangements and safer working arrangements.

**5.188** The key characteristics of DEEWR's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the significance and diversity of administered activities including personal benefits, employment service payments and a large number of diverse grant programs;
- reliance on data from third parties to support personal benefit payments, including those relating to working age related payments, child care benefits and rebates; and

- a relatively complex financial statement process that involves using data from a number of business systems and other agencies.

**5.189** In the light of these characteristics and the ANAO’s understanding of the operations of DEEWR, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

**Financial overview**

**5.190** DEEWR’s key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	634	786		
Revenue from government	564	713		
Administered income			194	313
Administered expenses			31 688	35 930
Total assets	406	425	1 163	1 335
Total liabilities	256	170	4 008	3 886

DEEWR’s estimated average staffing level (ASL) for 2012–13 is 3 790 (2011–12: 4 032\*).

\* This total excludes ASL relating to the Tertiary Education group function, which transferred to the then Department of Industry, Innovation, Science, Research and Tertiary Education as part of the Administrative Arrangements Order of 14 December 2011.

**Governance arrangements**

**5.191** The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DEEWR’s business objectives. These arrangements are designed to support DEEWR’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.192** The key elements of DEEWR’s corporate governance arrangements include:

- an executive management group that meets regularly and addresses strategic issues, monitors DEEWR’s financial performance, and oversees the operational performance of groups and programs;

- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on the effectiveness and probity of audit activities including risk assessment and management;
- a structured system of internal control;
- an internal audit function providing a risk based audit coverage of DEEWR's activities;
- mechanisms to facilitate internal and external assurances in relation to financial integrity, including the effectiveness of internal controls that may impact on the financial statements and the Secretary's annual Certificate of Compliance;
- a framework for incorporating risk management and the consideration of fraud risk into DEEWR's broader management and business planning processes; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

## **Areas of audit focus**

**5.193** In the light of the ANAO's understanding of DEEWR's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DEEWR's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- compliance activities and assurance processes underpinning personal benefit, child care and working age related payments that rely on correct disclosure of personal circumstances by a diverse number of recipients;
- the financial management of grants, as the management of grants is dispersed across a wide variety of programs and different business systems;
- complex judgements and estimates in DEEWR's financial statements including the accrual elements of administered programs required to be reported at year end; and



- legislative compliance, particularly the ongoing implementation of measures designed to address the risk of breaches of section 83 of the Constitution, referred to in the 2011–12 financial statements.

**5.194** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DEEWR's financial statements.

## Audit results

**5.195** The ANAO has reviewed the compliance activities and assurance processes relating to personal benefits, child care and employment related payments, as well as the grant management processes. A new moderate audit issue was identified in relation to DEEWR's grants management system, and is detailed below.

**5.196** The remaining areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.197** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	1	1
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>2</b>

### *New moderate audit issues*

#### Reconciliations

**5.198** In 2012–13, over \$8 billion in grant payments are expected to be processed through a number of IT applications within the school education management information system (SEMIS), an administered grants management system used to support the administration of numerous grant programs, and DEEWR's financial management information system (FMIS).

**5.199** The 2012–13 interim audit phase identified that statistical information from schools, used to support the calculation of grants paid under the *Schools Assistance Act 2008*, was not reconciled when being processed through the different IT applications within the SEMIS.

**5.200** In addition, the ANAO identified that until May 2013, reconciliations of grant payments were not being performed between the SEMIS and the FMIS.

**5.201** The non-performance of reconciliations within the SEMIS, and between the SEMIS and the FMIS increases the risk that inaccurate and/or incomplete information may be processed, resulting in incorrect recording of statistical information, incorrect payments and the misreporting of grant payments in the financial statements.

**5.202** At the time of the interim audit phase, DEEWR advised that it is in the process of implementing appropriate reconciliation processes.

#### *Actual and potential breaches of section 83 of the Constitution*

**5.203** In 2010–11, DEEWR became aware of the possibility of potential breaches of section 83 of the Constitution for payments made from special appropriations and special accounts, particularly in circumstances where the payments do not accord with conditions included in the relevant legislation.

**5.204** In 2011–12, DEEWR developed a plan to review the exposure to risks of non-compliance with statutory conditions on payments from special appropriations and special accounts. This plan involved assessing the difficulty of administering statutory conditions and assessing the extent to which existing payment systems and processes satisfy those conditions for each special appropriation and special account.

**5.205** The review identified payments totalling \$7 354 250 under the *Student Assistance Act 1973* and \$112 930 165 under the *Social Security (Administration) Act 1999* that were made in 2011–12 which were potentially in contravention of section 83 of the Constitution.

**5.206** DEEWR also identified small amounts of potential and actual breaches of section 83 under the *A New Tax System (Family Assistance) Act 1999* and the *Schools Assistance Act 2008* legislation.

**5.207** DEEWR has undertaken to continue to monitor the risk of section 83 non-compliance across all legislation for which it is administratively responsible. Where possible, DEEWR will continue to progress legislative

amendments and system changes to reduce the risk of future section 83 breaches.

**5.208** The ANAO will review progress in addressing this issue as part of the 2012–13 final audit phase.

## **Conclusion**

**5.209** Based on audit coverage to date, the ANAO identified that, except for the abovementioned issue, key elements of internal control were operating effectively to provide reasonable assurance that DEEWR will be able to prepare financial statements that are free of material misstatement. Additional audit procedures have been undertaken to address the risks arising from the audit issues referred to above. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Families, Housing, Community Services and Indigenous Affairs Portfolio

---

## Department of Families, Housing, Community Services and Indigenous Affairs

**5.210** The role of the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) is to provide social policy advice to the Australian Government and deliver the Australian Government's social policy agenda. FaHCSIA aims to improve the lives of Australians by creating opportunities for economic and social participation by individuals, families and communities. The seven core areas in which FaHCSIA seeks to assist people are: families and children; housing; community capability and the vulnerable; seniors; disability and carers; women; and Indigenous.

**5.211** FaHCSIA's business operations include:

- payments to individuals: FaHCSIA makes a range of direct payments to individuals including the age pension, the disability support pension and the family tax benefit (FTB) through the Department of Human Services (DHS) and other agencies;
- working with the states and territories: FaHCSIA works with the states and territories to achieve outcomes in their areas of responsibility including housing, disability services, addressing Indigenous disadvantage, concessions and the welfare of children;
- payments for community services: FaHCSIA funds community-based organisations to deliver a range of local services, including family relationship services, emergency relief and supported employment for people with a disability; and
- policy development, leadership, advice and coordination: FaHCSIA supports its Ministers in their policy roles by providing advice on social policy, building the evidence base for decisions and action and in whole of government policy coordination for Indigenous affairs and for women.

**5.212** The key characteristics of FaHCSIA's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the diverse range of personal benefit payments administered by FaHCSIA, and the reliance placed on voluntary disclosure of information by recipients;
- reliance on other government agencies to deliver personal benefit payments that are based on complex legislative requirements and that are reported in FaHCSIA's financial statements;
- significant judgements involved in estimating material financial statement balances, such as the Family Tax Benefit provision; and
- the need to comply with numerous grant payment conditions, and a decentralised grant management function.

**5.213** In the light of these characteristics and the ANAO's understanding of the operations of FaHCSIA, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

**5.214** FaHCSIA's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	606	594		
Revenue from government	548	532		
Administered income			152	639
Administered expenses			82 714	80 081
Total assets	351	349	6 063	5 380
Total liabilities	147	147	9 459	8 713

FaHCSIA's estimated average staffing level for 2012–13 is 2 920 (2011–12: 2 754).

## Governance arrangements

**5.215** The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of FaHCSIA's business objectives. These arrangements are designed to support FaHCSIA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.216** The key elements of FaHCSIA's corporate governance arrangements include:

- an Executive Management Group (EMG) that meets fortnightly. The EMG takes an active interest in the financial operations of FaHCSIA and receives monthly detailed reports from the Chief Finance Officer (CFO);
- a committee framework, including the Assurance, Audit and Risk Committee (AARC). The AARC meets at least quarterly and focuses attention on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes and related controls. A Financial Statements Sub-Committee, comprising an independent AARC member, the CFO and a FaHCSIA Branch Manager, monitors and reviews FaHCSIA's financial reporting timetable and requirements;
- an Assurance and Compliance Branch that undertakes risk-based audit coverage of FaHCSIA's activities;
- a risk management framework that promotes a coordinated risk management regime, and a risk management toolkit that encourages staff to apply risk management principles. FaHCSIA has recently initiated a project to review its approach to risk management with a view to strengthening the department's risk management framework; and
- a fraud risk assessment process and fraud control plan.

### **Areas of audit focus**

**5.217** In the light of the ANAO's understanding of FaHCSIA's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on FaHCSIA's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- FaHCSIA's controls over personal benefit payments, as it has ultimate responsibility for the administration, funding and reporting of personal benefit payments and related debts that are processed by DHS under a Bilateral Management Arrangement. In relation to the assessment and payment of many personal benefits, FaHCSIA and DHS rely on voluntary disclosure of information by customers;

- the valuation of personal benefit related asset and liability balances due to the significance of actuarial estimates and judgements involved in the complex valuation process;
- the financial management of grants, including the adequacy of documentation to support grant acquittals. FaHCSIA administers a large number of grant payments to State and Territory Governments, other service providers and program recipients using different business systems; and
- legislative compliance, particularly the implementation of measures designed to address the risk of non-compliance with section 83 of the Constitution, referred to in the 2011–12 financial statements.

**5.218** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of FaHCSIA's financial statements.

## **Audit results**

**5.219** The ANAO has substantially completed its interim audit phase coverage to assess the effectiveness of internal controls in those areas of audit focus that have the potential to impact on FaHCSIA's financial statements, including audit coverage of IT application controls and grants accounting.

**5.220** Audit coverage on these and other areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.221** To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

**5.222** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

## Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	0	0
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>

### *Actual and potential breaches of section 83 of the Constitution*

5.223 During 2011–12, FaHCSIA undertook a review to determine the risk of payments being made in breach of section 83 of the Constitution from the special appropriations, special accounts and annual appropriations for which it is administratively responsible. The risk assessment and subsequent analysis identified actual breaches for payments made from the Aboriginals Benefit Account (ABA) under section 64(3) of the *Aboriginal Land Rights (Northern Territory) Act 1976* and potential breaches for certain personal benefit payments made pursuant to:

- *A New Tax System (Family Assistance) Act 1999* and *A New Tax System (Family Assistance) (Administration) Act 1999*;
- *Paid Parental Leave Act 2010*; and
- *Social Security Act 1991* and *Social Security (Administration) Act 1999*.

5.224 These actual and potential breaches were reported in Note 29 of FaHCSIA’s 2011–12 financial statements. The 2011–12 auditor’s report included a report on other legal and regulatory requirements referring to the actual and potential breaches.

5.225 At the time of signing the 2011–12 financial statements, FaHCSIA was seeking legal advice on whether payments made in certain circumstances pursuant to *A New Tax System (Family Assistance) Act 1999* or *A New Tax System (Family Assistance) (Administration) Act 1999* resulted in payments being in breach of section 83. FaHCSIA has now obtained the legal advice that concludes that these payments are not likely to be in breach of section 83.

5.226 FaHCSIA is also progressing legislative changes to the *Aboriginal Land Rights (Northern Territory) Act 1976* to reduce the risk of section 83 breaches. At



the end of March 2013, FaHCSIA had identified three actual section 83 breaches (2011–12: nine) relating to payments made from the ABA and two actual section 83 breaches (2011–12: nil) relating to payments made from the Social and Community Services Pay Equity Special Account.

**5.227** FaHCSIA has undertaken to continue to monitor the risk of section 83 non-compliance across all legislation for which it is administratively responsible. Where possible, amendments to legislation will be progressed with the aim of reducing the risk of future section 83 breaches.

**5.228** The ANAO will review progress in addressing this issue as part of the 2012–13 final audit phase.

## **Conclusion**

**5.229** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that FaHCSIA will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Finance and Deregulation Portfolio

---

## Department of Finance and Deregulation

**5.230** The Department of Finance and Deregulation (Finance) assists the Government to achieve its outcomes in a variety of policy and program areas, including expenditure and financial management, deregulation reform and the operations of government. Services delivered by Finance include assisting the Government to make informed decisions on government finances and regulation making through: budgetary management and advice; transparent financial reporting; implementation of a robust financial framework; and best practice regulatory processes.

**5.231** Finance's business operations include improving government administration and operations through policies, systems and advice on:

- procurement;
- Commonwealth non-defence domestic property management and construction;
- Government enterprises;
- general insurance and risk management; and
- the application of information and communications technology.

**5.232** Finance also provides support for Parliamentarians, organisations and others with entitlements as approved by Government, through the delivery of entitlements and targeted assistance.

**5.233** The key characteristics of Finance's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- a number of financial statement balances that require significant judgement, or the use of specialists, to estimate;
- a complex financial statement process that involves aggregating data from a number of business systems and other agencies; and
- numerous arrangements with service providers that effect key financial statement balances.

**5.234** In the light of these characteristics and the ANAO's understanding of the operations of Finance, the ANAO has assessed, for the purposes of

planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.235 Finance’s key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	243	184		
Revenue from government	275	235		
Administered income			2 277	2 915
Administered expenses			10 426	12 082
Total assets	2 409	2 276	15 700	18 571
Total liabilities	472	457	94 448	151 472

Finance’s estimated average staffing level for 2012–13 is 1 528 (2011–12: 1 536).

## Governance arrangements

5.236 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of Finance’s business objectives. These arrangements are designed to support Finance’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.237 The key elements of Finance’s corporate governance arrangements include:

- a monthly executive board meeting that discusses strategic matters and operations management and to consider new policies and projects;
- an audit committee, chaired by an independent member, that meets at least quarterly and focuses on governance, risk management, internal controls, compliance management, financial reporting and ANAO activities;
- a financial statement audit sub-committee to assist the audit committee with reviewing the department’s financial statements, certificate of compliance and related financial matters;

- an IT governance sub-committee to provide assurance and advice to the executive board by ensuring that effective and appropriate procedures, controls and decision making processes are in place to support the department's Information and Communication Technology (ICT) strategic capability, operational capacity and regulatory conformance;
- an internal audit function providing an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives;
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and the annual Certificate of Compliance process;
- a comprehensive risk management process, both at an organisational and discrete activity level, that includes an assessment of inherent and control risks, identification of the controls in place to address these risks, and an understanding of the residual risks that remain and how these can be managed to an acceptable level;
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports; and
- a fraud risk assessment process, involving input from each business group in Finance with fraud oversight roles, collated into a fraud control plan that includes risk reduction strategies.

## **Areas of audit focus**

**5.238** In the light of the ANAO's understanding of Finance's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Finance's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the complexity of the assumptions and calculations underpinning the actuarial assessment of the public sector unfunded superannuation liability;

- the consistency of the valuation methods and assumptions applied to the numerous properties in the Australian Government’s domestic portfolio;
- accounting for the major claims and complex assumptions underpinning the valuation of the outstanding claims under the Australian Government’s self-managed general insurance fund (Comcover);
- the control regime in relation to entitlements paid to Parliamentarians and their staff due to the complexity of these entitlement arrangements; and
- legislative compliance, particularly the implementation of measures designed to address the risk of a breach of section 83 of the Constitution, referred to in the 2011–12 financial statements.

5.239 As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of Finance’s financial statements.

**Audit results**

5.240 To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

5.241 The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

**Status of audit issues raised by the ANAO**

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	0	0
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>

## *Actual and potential breaches of section 83 of the Constitution*

**5.242** During 2011–12, Finance undertook a review to determine the risk of payments being made in breach of section 83 from the special appropriations and special accounts for which it is administratively responsible.

**5.243** The risk assessment and subsequent analysis conducted up to 30 June 2012 identified 2 521 breaches of section 83 totalling \$5.6 million in relation to various superannuation payments under the *Superannuation Act 1976*, the *Superannuation Act 1990*, the *Parliamentary Contribution Superannuation Act 1948* and the *Judges Pensions Act 1968*. Legislative amendments to each of these Acts, with the exception of the *Judges Pensions Act 1968*, were passed in late June 2012 reducing the risk of payments in the future being made in breach of section 83 to low. Legislative amendments have been introduced in 2012–13 to address breaches in regards to the *Judges Pensions Act 1968*.

**5.244** The risk of payments from other special appropriations being in breach of section 83 was assessed by Finance as low or moderate, with the exception of the following legislation, where the review process, including obtaining legal advice, was well advanced, but not completed, at 30 June 2012:

- *Parliamentary Entitlements Act 1990*;
- *Ministers of Parliament (Life Gold Pass) Act 2002*; and
- section 66 of the Constitution in relation to the salaries of Ministers.

**5.245** Legal advice in regards to the risk of payments being in breach of section 83 for the above legislation was outstanding but was expected to be finalised by 30 June 2013. Finance has developed processes designed to capture and report any potential breaches pending the legal advice.

## **Conclusion**

**5.246** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Finance will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

## The Board of Guardians and the Future Fund Management Agency

**5.247** The Future Fund Management Agency (FFMA) was established by the *Future Fund Act 2006* to support and advise the Future Fund Board of Guardians (Board) in its task of investing the assets of the Future Fund.

**5.248** The FFMA's business operations include:

- continued development and implementation of an investment strategy for the Future Fund and the three Nation Building Funds – the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund, agreed by the Board and consistent with the investment mandate from Government;
- investing the assets of the Future Fund and the three Nation Building Funds in accordance with the relevant investment strategies; and
- the goal of maximising of returns earned on contributions to the Future Fund over the long term, in line with the investment mandate.

**5.249** The key characteristics of the FFMA's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- complexities associated with the valuation of different investment instruments;
- the use of external service providers to support the investment management function; and
- a complex organisational structure involving a number of subsidiaries, used as special purpose investment vehicles, and associated tax implications.

**5.250** In the light of these characteristics and the ANAO's understanding of the operations of the FFMA, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.251 The FFMA's key financial balances<sup>46</sup> are:

Key financial balances	Estimated	Actual
	(\$m) 2012–13	(\$m) 2011–12
Total income	10 642	2 104
Total expenses	567	428
Operating result	10 075	1 676
Total assets	87 495	78 250
Total liabilities	474	1 304

The FFMA's estimated average staffing level for 2012–13 is 91 (2011–12: 83).

## Governance arrangements

5.252 The agency has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of the FFMA's business objectives. These arrangements are designed to support the FFMA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.253 The key elements of the FFMA's corporate governance arrangements include:

- a strategic asset allocation that provides an overview of the Board's investment plan;
- meetings of the Future Fund Board of Guardians at least ten times per year;
- a governance committee framework, including a Board audit committee and a FFMA operational risk and compliance committee;
- a governance framework, including an audit committee, risk committee, governance committee, conflicts committee and a remunerations and nominations committee;

---

<sup>46</sup> The Future Fund presents its financial statements in a format consistent with that used in the funds management industry and the funding of the FFMA is drawn from the investment special account. For 2012–13 this funding is estimated to be \$44 million.



- mechanisms to facilitate internal and external assurances in respect of financial integrity, including the effectiveness of internal controls that impact on financial records;
- the use of a risk and control matrix to support the FFMA in monitoring the key risks of the organisation;
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas including the preparation of monthly financial reports; and
- significant operational controls that reside with the outsourced custodian. These controls are subject to an independent bi-annual internal controls audit which tests that the controls are appropriately designed and are operating effectively. A substantive independent audit is also undertaken at 30 June each year to obtain assurance in relation to the existence of all assets and the valuation of public market assets. Independent valuations and audited financial statements are obtained for most private market assets.

### **Areas of audit focus**

**5.254** In the light of the ANAO's understanding of the FFMA's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on the FFMA's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the valuation of investments from the perspectives of governance, financial accuracy and regulatory oversight;
- the compliance function that reinforces internal assurance procedures;
- the processes for monitoring external service providers, including the custodian;
- group consolidation and tax implications relating to wholly owned subsidiaries; and
- reviewing the FFMA operations, as reflected in its special accounts, against constitutional requirements.

**5.255** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of the FFMA's financial statements.

## **Audit results**

**5.256** No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of the areas of audit focus to date. The 2011–12 audit did not identify any new significant or moderate audit issues.

## **Conclusion**

**5.257** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the FFMA will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Foreign Affairs and Trade Portfolio

---

## Department of Foreign Affairs and Trade

**5.258** The Department of Foreign Affairs and Trade's (DFAT) role is to advance the interests of Australia and Australians internationally.

**5.259** DFAT's business operations include:

- the advancement of Australia's international strategic, security and economic interests through bilateral, regional and multilateral engagement on Australian Government foreign and trade policy priorities;
- the protection and welfare of Australians abroad and access to secure international travel documentation through timely and responsive travel advice, and consular and passport services in Australia and overseas; and
- a secure Australian Government presence overseas through the provision of security services and information and communications technology infrastructure, and the management of the Australian Government's overseas owned estate.

**5.260** The key characteristics of DFAT's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the geographical spread of operations;
- the importance of DFAT's IT environment including business continuity and disaster recovery planning; and
- the reliance on external service providers for key operations and financial information. Under service level arrangements with DFAT, these service providers provide revenue collection services for passport applications and undertake a range of property, financial and facilities management services for the overseas estate.

**5.261** In the light of these characteristics and the ANAO's understanding of the operations of DFAT, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.262 DFAT's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	930	876		
Revenue from government	883	822		
Administered income			624	433
Administered expenses			278	280
Total assets	3 159	3 094	424	454
Total liabilities	270	270	55	61

DFAT's estimated average staffing level for 2012–13 is 3 923 (2011–12: 3 916).

## Governance arrangements

5.263 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DFAT's business objectives. These arrangements are designed to support DFAT's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.264 The key elements of DFAT's corporate governance arrangements include:

- an Executive Committee that oversees the operational performance of divisions and posts, reviews departmental wide issues, monitors financial performance and considers reports prepared and referred by other management committees;
- a governance committee framework including an audit and risk committee. This committee meets at least quarterly and has a focus on the efficiency, effectiveness and probity of activities including risk assessment and management, internal audit planning and results, fraud control and ANAO audit activities;
- a risk management framework and plan that identifies and assists in the management of risk at the strategic, business and project levels, and also at specific locations overseas;

- a periodic fraud risk assessment undertaken in line with the Commonwealth Fraud Control Guidelines; and
- an internal audit strategy and plan that aligns with the department's risk assessment and management priorities.

### **Areas of audit focus**

**5.265** In the light of the ANAO's understanding of DFAT's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DFAT's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- revenue generated from passport operations. A majority of the passport revenue collections are outsourced to the Australian Postal Corporation;
- the completeness of departmental revenue for rental accommodation and services provided to other Government agencies at overseas posts due to the significance of these functions to DFAT's financial statements;
- valuation of the Australian Government's overseas property due to the significance of the balance to the financial statements and the impact of global economic conditions on fair value estimation processes; and
- overseas post operations, as a significant component of DFAT's departmental financial statements relate to financial operations performed at overseas locations.

**5.266** The ANAO will continue to provide audit coverage of the following areas which have previously been identified as having a significant impact on the financial statements:

- the accounting treatment and disclosure of the transactions in the National Interest Account (NIA) that are reported by the Commonwealth where the recovery of loans made by the Australian Government to overseas governments is considered less than probable. The NIA is used to process transactions undertaken by the Export Finance and Insurance Corporation, after consideration by the Minister of whether they are in the national interest; and

- executive remuneration and appropriation note disclosures due to the complexity of these disclosures.

5.267 As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DFAT's financial statements.

## **Audit results**

5.268 The ANAO's interim audit phase coverage to date has included a review of the controls around passport revenue collections, the recording of departmental revenues and site visits to review post operations in India, China, Singapore and South Africa.

5.269 The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

5.270 No significant or moderate audit issues have been identified by the ANAO as a result of the audit coverage of the areas of audit focus to date. There were no significant or moderate audit issues in 2011–12.

## **Conclusion**

5.271 Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DFAT will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Health and Ageing Portfolio

---

## Department of Health and Ageing

**5.272** The role of the Department of Health and Ageing (DoHA) is to achieve better health and active ageing for all Australians. DoHA works to achieve this through its policy advice, management of programs, research and regulation activities, and working closely with other governments, government agencies, consumers and other stakeholders.

**5.273** DoHA's business operations include:

- policy development and working closely with third parties to deliver services in relation to population health; pharmaceutical services; medical services; aged care and population ageing; primary care; rural health; hearing services; Indigenous health; private health; health system capacity and quality; mental health; health workforce capacity; acute care; and biosecurity and emergency response;
- institutional reforms negotiated with state and territory governments in the period since 2008 and culminating in the National Health Reform Agreement in August 2011;
- reform of ageing and aged care to deliver an integrated package of measures focussing on benefits to older Australians including more support and care at home, access to residential care, recognition of carers and support for those with dementia; and
- reform of dental care to address the long waiting lists for public dental services and aims to boost the dental workforce, particularly in rural and remote areas.

**5.274** The key characteristics of DoHA's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- a complex operating environment that involves working with multiple government jurisdictions and agencies, and a range of other stakeholders;
- the significant size of administered payments, which include high volume and complex Medicare and pharmaceutical personal benefits and aged care subsidies processed by the Department of Human Services on behalf of DoHA, and significant grant payments;

- a complex funding model and extensive appropriations disclosure; and
- the consolidation of the Therapeutic Goods Administration in DoHA's financial statements.

5.275 In the light of these characteristics and the ANAO's understanding of the operations of DoHA, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.276 DoHA's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	648	667		
Revenue from government	625	636		
Administered income			1 114	2 208
Administered expenses			52 083	49 704
Total assets	494	524	1 099	1 009
Total liabilities	298	329	2 952	3 418

DoHA's estimated average staffing level for 2012–13 is 4 706 (2011–12: 4 776).

## Governance arrangements

5.277 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of its business objectives. These arrangements are designed to support DoHA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.278 The key elements of DoHA's corporate governance arrangements include:

- an Executive Committee, chaired by the Secretary, that is responsible for the management and oversight of all major department policy, financial and operational decision making;
- a governance committee framework including an audit committee that includes two independent members, one of whom is the Chair, meets at



least quarterly and provides advice and assistance on risk, control and compliance frameworks;

- an internal audit function that has primary responsibility for promoting and improving corporate governance within DoHA and operates under the direction of the Secretary and the audit committee;
- a risk management framework including Chief Executive Instructions, Procedural Rules, a Risk Management Policy and an Enterprise Risk Management Plan;
- a fraud control plan that is monitored and reviewed on a cyclical basis in line with the Commonwealth Fraud Control Guidelines;
- a Certificate of Compliance regime that incorporates semi-annual control self assessments, that forms a key part of DoHA's corporate governance and compliance framework; and
- governance arrangements with the Department of Human Services to manage the relationship between the two agencies regarding significant administered payments.

### **Areas of audit focus**

**5.279** In the light of the ANAO's understanding of DoHA's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DoHA's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the high volume and complex administered personal benefits and subsidies processed by the Department of Human Services;
- a complex valuation methodology used to estimate the Government's liabilities under the medical indemnity program;
- the diverse range of administered grant payments to State and Territory governments, other service providers and program recipients;
- valuation of internally generated software involving significant judgement;
- management, accounting and disclosure of the National Medical Stockpile for slow moving and expired inventory;

- the complexity of appropriations reporting and disclosure covering 14 outcomes; and
- legislative compliance, particularly the implementation of measures designed to address the risk of non-compliance with section 83 of the Constitution, referred to in the 2011–12 financial statements.

**5.280** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DoHA’s financial statements.

## Audit results

**5.281** The ANAO’s interim audit phase has focused on DoHA’s IT control environment, key systems and controls in the areas which have been identified as having an impact on the financial statements. The ANAO will complete audit coverage of areas of audit focus including valuation, estimation processes and reporting of appropriations during the 2012–13 final audit phase.

**5.282** No significant or moderate audit issues have been identified during the 2012–13 interim audit phase.

**5.283** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	0	0
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>

### *Actual and potential breaches of section 83 of the Constitution*

**5.284** During 2011–12, DoHA undertook a review to determine the risk of payments being made in breach of section 83 of the Constitution from the special appropriations and special accounts for which it is administratively responsible. The risk assessment and subsequent analysis identified some

actual breaches of Medicare payments made under the *Health Insurance Act 1973* and potential breaches for certain personal benefit payments made under the:

- *Health Insurance Act 1973*;
- *Private Health Insurance Act 2007*;
- *National Health Act 1953*; and
- *Aged Care Act 1997*.

**5.285** These actual and potential breaches were reported in Note 25B of DoHA's 2011–12 financial statements. The 2011–12 auditor's report included a report on other legal and regulatory requirements referring to the actual and potential breaches.

**5.286** DoHA has undertaken to continue to monitor its level of compliance with section 83 of the Constitution across all legislation for which it is administratively responsible.

**5.287** In 2012–13, DoHA developed an approach to reduce the risk of breaches of section 83 of the Constitution. This includes:

- ongoing review of new legislation and payment processes in relation to special appropriations;
- proposing minor amendments to legislation identified through the legislative review;
- ongoing review of DoHA's programs through the internal audit activity and various compliance program; and
- liaison with the Department of Human Services to identify error rates and risk areas in relation to payments made by the Department of Human Services on behalf of DoHA.

**5.288** The ANAO will review the outcome of DoHA's approach to reduce the risk of section 83 of the Constitution during the final phase of the 2012–13 audit.

## **Conclusion**

**5.289** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DoHA will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Human Services Portfolio

---

## Department of Human Services

**5.290** On 1 July 2011 the *Human Services Legislation Amendment Act 2011* integrated the services of Medicare Australia and Centrelink into the Department of Human Services (DHS).

**5.291** DHS provides policy advice on service delivery matters to government aimed at ensuring effective, innovative and efficient implementation of government service delivery.

**5.292** DHS delivers a range of government and other payments and services to Australians through its three main programs:

- Medicare which looks after the health of Australians through services and payments such as Medicare, the Pharmaceutical Benefits Scheme, the Australian Childhood Immunisation Register and the Australian Organ Donor Register;
- Centrelink which delivers a range of government payments and services for retirees, the unemployed, families, carers, parents, people with disabilities, Indigenous Australians, and people from diverse cultural and linguistic backgrounds, and provides services at times of major change; and
- Child Support which provides support to separated parents so they have the financial and emotional support necessary for their children's wellbeing.

**5.293** The key characteristics of DHS business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- voluntary disclosures of information by customers in relation to the assessment and payment of personal benefits;
- the complexity of the IT environment to support significant business operations, including developing and managing internal systems for personal benefit payments;
- management of agreements and arrangement with policy departments and agencies relating to service delivery responsibilities;

- the quality assurance mechanisms implemented by the department to gain assurance over the accuracy of personal benefit payments;
- the implementation of service delivery reforms transforming the way that DHS delivers its services to customers by simplifying processes, extending access to services and delivering services more efficiently; and
- child support arrangements, particularly in relation to child support assessments and payments that are subject to complex legislative requirements.

5.294 In the light of these characteristics and the ANAO's understanding of the operations of DHS, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.295 DHS key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2012–13	Actual (\$m) 2011–12	Estimated (\$m) 2012–13	Actual (\$m) 2011–12
Net cost of services	4 229	4 237		
Revenue from government	3 908	3 938		
Administered income			1 446	1 413
Administered expenses			1 442	1 398
Total assets	1 751	2 020	759	748
Total liabilities	1 275	1 400	756	742

DHS estimated average staffing level for 2012–13 is 32 048 (2011–12: 32 592).

## Governance arrangements

5.296 DHS has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of its business objectives. These arrangements are designed to support its financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.297 The key elements of DHS corporate governance arrangements include:

- a strategic planning and performance framework focusing on priorities and the effective use of DHS resources;
- a governance committee structure comprising an Executive Committee chaired by the Secretary and seven supporting governance committees, including an audit committee, to provide oversight of the delivery and monitoring of DHS outcomes;
- an organisation structure providing lines of accountability and responsibility to enhance DHS compliance and decision making processes;
- an established risk management framework and plan that identifies and assists management of risks at various levels of the department;
- an internal audit function reporting to the Secretary and the audit committee on the risk based audit coverage of DHS activities; and
- an extensive fraud control and investigations framework which includes strategies for fraud prevention, detection and resolution.

## Areas of audit focus

5.298 In the light of the ANAO's understanding of DHS environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DHS financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- programs and related payments delivered by DHS that are complex in nature and of substantial value. Generally, these programs are delivered on behalf of other agencies, including the Departments of: Health and Ageing; Veterans' Affairs; Families, Housing, Community Services and Indigenous Affairs; Education, Employment and

Workplace Relations; and Industry, Innovation, Climate Change, Science, Research and Tertiary Education.

- child support transactions, specifically focusing on complexities associated with IT system controls, as well as the valuation methodology used to determine child support debts that DHS may not be able to collect from the paying parent;
- intangible assets due to the complexities associated with the valuation and measurement of these assets and the significance of the carrying value of the assets in the financial statements; and
- legislative compliance, particularly the implementation of measures designed to address the risk of a breach of section 83 of the Constitution prior to making benefit payments on behalf of other agencies.

**5.299** As an integral part of the interim audit phase, the ANAO continues to review the IT general and application controls for key systems that support the preparation of DHS financial statements.

## Audit Results

**5.300** The ANAO has substantially completed its interim audit phase coverage to assess the effectiveness of internal controls in these areas of audit focus including IT general controls. Audit coverage will be completed during the 2012–13 final audit phase.

**5.301** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	2	(1)	1	2	(2)*	2	2
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>2</b>	<b>(1)</b>	<b>2</b>	<b>3</b>	<b>(2)</b>	<b>2</b>	<b>3</b>

\* One moderate audit issue relating to IT network user access management and monitoring was downgraded to a category C finding.



*Resolved audit issues*

## Personal benefit fee details

**5.302** During the 2011–12 interim audit phase, the ANAO reported a number of discrepancies between the fee details recorded in the treatment accounts system (TAS) for medical, hospital and allied health services claims processed by DHS on behalf of the Department of Veterans' Affairs and the amounts that can be claimed (the fee) for each type of service, as detailed in the approved Schedule of Benefit. During the 2011–12 final audit phase, DHS was undertaking work to address this issue. In the 2012–13 interim audit phase, the ANAO identified that DHS had implemented system changes and procedures to strengthen and minimise discrepancies between TAS and the Schedule of Benefits. As a result, this finding has been satisfactorily resolved.

## IT Network user access management and monitoring

**5.303** In the 2011–12 final audit phase, the ANAO reported weaknesses in the management of user access to the DHS IT network. System access rights of a number of terminated DHS employees had not been deactivated and instances were noted where there was a lack of documentation supporting new user access to the IT network. The ANAO also identified that activities of users with privileged access to financial applications were only monitored on an ad hoc basis. These issues increased the risk of unauthorised system changes compromising the integrity of the data maintained in the various IT applications supporting the financial information.

**5.304** During the 2012–13 interim audit phase, the ANAO identified that DHS had implemented a number of control procedures which includes a monthly monitoring regime and a review of access to production source code for computer applications. DHS is also working on the implementation of further controls. As a result this issue has been downgraded to a category C finding.

*New audit issues*

## Privileged user access to the financial management information system

**5.305** During the 2012–13 interim audit phase, the ANAO identified that DHS had a number of user accounts in the financial management information system (FMIS) that provided privileged access. Users with privileged access to IT systems are able to edit and change data within systems and by-pass the controls designed to ensure appropriate segregation of duties. Access to these user accounts was logged but not monitored. This weakness increases the risk

of unauthorised or fraudulent transactions being processed, potentially compromising the integrity of financial data. DHS has advised that controls are being strengthened on the use of these accounts. The ANAO will review the action taken by DHS during the 2012–13 final audit phase.

The financial management information system control environment

**5.306** The FMIS includes functionality to assist with testing of any changes to the system. This functionality allows the creation of test data and then its deletion when testing is completed, and the system is ready to be used in a live production environment. This functionality must not be able to be used in the production environment in order to ensure data is not exposed to deliberate or inadvertent modification, increasing the risk of inaccurate financial information.

**5.307** During the 2012–13 interim audit phase, the ANAO identified that the test functionality was operating in the production environment. DHS had advised that action has been taken to address this issue. The ANAO will review the work performed by DHS during the 2012–13 final audit phase.

### *Legislative breaches*

Actual breaches of section 83 of the Constitution

**5.308** During 2011–12, DHS undertook a review to determine the risk of payments being made in breach of section 83 of the Constitution from the special appropriation and special accounts for which it is responsible. The risk assessment and subsequent analysis identified actual section 83 breaches in the following special accounts:

- Child Support Special Account – two payments totalling \$2.019 million made under the *Child Support (Registration and Collection) Act 1988*;
- Superannuation Clearing House Special Account – three payments totalling \$9 044; and
- Recovery of Compensation for Health Care and Other Services Special Account – two payments totalling \$6 272.

**5.309** These actual breaches were reported in Note 35 of DHS 2011–12 financial statements. The 2011–12 auditor’s report included a report on other legal and regulatory requirements referring to section 83 actual breaches.

**5.310** In order to reduce the risk of non-compliance with section 83 of the Constitution, DHS has initiated system and procedural changes and undertaken a review of transactions in the special accounts.

**5.311** The ANAO's 2012–13 financial statements audit coverage will continue to monitor and assess DHS review of special accounts to identify any payments that are not in accordance with the conditions included in the relevant legislation and therefore lead to breaches of section 83 of the Constitution.

## **Conclusion**

**5.312** Based on audit coverage to date, the ANAO identified that, except for the abovementioned issues, key elements of internal control were operating effectively to provide reasonable assurance that DHS will be able to prepare financial statements that are free of material misstatement. Additional audit procedures will be undertaken to address the risks arising from the audit issues referred to above. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Immigration and Citizenship Portfolio

---

## Department of Immigration and Citizenship

**5.313** The Department of Immigration and Citizenship (DIAC) is responsible for the delivery of a range of programs and services for the purpose of building Australia's future through the well-managed entry and settlement of people into Australia.

**5.314** DIAC's responsibilities include:

- contributing to Australia's future through managed migration;
- protecting refugees and contributing to humanitarian policy internationally;
- contributing to Australia's security through border management and traveller facilitation;
- making fair and reasonable decisions for people entering or leaving Australia, ensuring compliance with Australia's immigration laws and integrity in decision making;
- supporting migrants and refugees to settle into the Australian community and participate in Australian society; and
- promoting Australian citizenship and a multicultural Australia.

**5.315** The key characteristics of DIAC's operations that shape the ANAO's 2012–13 financial statement audit include the:

- expansion of the immigration detention network, as a result of an increase in the number of people in immigration detention and the implementation of the recommendations of the Report of the Expert Panel on Asylum Seekers;
- large number of significant third-party contracts for the delivery of DIAC services, particularly in relation to detention operations;
- decentralised processing of visa application charge revenue across DIAC's Australian and overseas offices, supported by multiple IT systems with the involvement of the Department of Foreign Affairs and Trade, and, to a lesser extent, the Australian Trade Commission;

- increase in the number of visa applications and visa revenue, as a result of a decision to increase the number of places in the migration program and proposed changes to visa application fees; and
- complexities of DIAC's appropriation funding that includes variable and quarantined funding that is governed by work load and no-win no-loss agreements<sup>47</sup>.

**5.316** In the light of these characteristics and the ANAO's understanding of the operations of the department, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

**5.317** DIAC's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	1 494	1 429		
Revenue from government	1 376	1 331		
Administered income			1 239	1 083
Administered expenses			2 297	1 540
Total assets	794	797	1 173	961
Total liabilities	421	415	228	389

DIAC's estimated staffing level for 2012–13 is 8 997 (2011–12: 8 682).

## Governance arrangements

**5.318** The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DIAC's business objectives. These arrangements are designed to support DIAC's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

<sup>47</sup> No-win no-loss arrangements refer to funding provided by the Australian Government to fund all expenditure incurred relating to DIAC's handling of asylum seekers.

**5.319** The key elements of DIAC's governance arrangements include:

- an executive management committee, which assists the Secretary in setting corporate priorities and determining the standards by which success in achieving its priorities are measured;
- a corporate leadership group which focuses on key strategic topics and the communication of key messages;
- governance committees with oversight of particular risk areas in DIAC, including fraud, integrity and security, people management, systems, performance management, and values and standards;
- an audit committee that focuses on matters relating to risk management, internal audit, external audit, fraud control and financial reporting;
- a financial statement sub-committee of the audit committee that meets regularly, focussing on financial statement issues, risks and deliverables; and
- an internal audit function that delivers a strategic risk-based internal audit plan designed to assist line areas meet their key objectives through a combination of performance and compliance based audits.

**5.320** DIAC has a monthly financial reporting process that provides reports to the executive and divisions for review and analysis. The reports include a summary of the key financial issues to be considered by management, actual versus budgeted departmental revenue and expenditure by division, projected operating results, expenditure against capital budgets and a cash impact statement.

## **Areas of audit focus**

**5.321** In the light of the ANAO's understanding of DIAC's environment and governance arrangements, including its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DIAC's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the accuracy and completeness of asset records given the increased funding for administered assets as a result of the recommendations of the Report of the Expert Panel on Asylum Seekers, which included the

establishment of regional processing centres in Nauru and Papua New Guinea;

- the revaluation of DIACs administered and departmental non-financial assets, given their significance and the expansion of the detention services network;
- increased administered expenses in relation to detention services, primarily in relation to implementing the recommendations included in the Report of the Expert Panel on Asylum Seekers;
- appropriation revenue recognised under DIAC's work load and no-win no-loss agreements; and
- the follow up of the implementation of measures designed to address the risk of a breach of section 83 of the Constitution, referred to in the 2011–12 financial statements.

**5.322** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DIAC's financial statements.

## **Audit results**

**5.323** The ANAO's interim audit phase coverage to date has included a review of the controls relevant to DIACs assets, visa revenue, and administered expenses. The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.324** No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of the areas of audit focus to date. The 2012–13 audit did not identify any new significant or moderate audit issues.

**5.325** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

## Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)*	0	0	0	0	0
L1	0	0	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

\* This issue was resolved as part of the 2011–12 final audit phase and reported in ANAO Audit Report No.16 2012–13 *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2012*.

## Conclusion

5.326 Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DIAC will be able to prepare financial statements that are free from material misstatement. The effective operation of internal controls for the full financial year will be assessed during the 2012–13 final audit phase.



# Industry, Innovation, Climate Change, Science, Research and Tertiary Education Portfolio

---

## Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education

**5.327** The Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education (DIICCSRTE) works with stakeholders to help build the economy of the future, through supporting education, skills development, scientific and research collaboration, innovation and productivity increases.

**5.328** DIICCSRTE is focussed on promoting technological, social and environmental innovation and shaping businesses, industries and the workforce to turn these opportunities into action.

**5.329** As a result of the Machinery of Government (MoG) changes on 25 March 2013, the climate change functions from the former Department of Climate Change and Energy Efficiency (DCCEE) were transferred to the department. The primary focus of the functions transferred is to lead the development and coordination of Australia's climate change policy.

**5.330** DIICCSRTE's business operations include:

- contributing to the sustainable development and growth of Australian industry, particularly the manufacturing, services and small business sectors, by encouraging businesses to innovate, collaborate, and commercialise ideas, and by delivering business advice, assistance and services;
- contributing to the production, use and awareness of science and research knowledge by supporting research activity, training and infrastructure, science communication, skill development, and collaboration within the research sector and between researchers and industry, domestically and internationally;
- achieving growth in skills, qualifications and productivity through funding to improve teaching quality, learning and tertiary sector infrastructure, international promotion of Australia's education and training sectors, and partnerships with industry; and

- reduction of Australia's greenhouse gas emissions; adaptation to the impacts of climate change and negotiation of an effective global solution through the development and implementation of a national response to climate change and bilateral, regional and multilateral engagement internationally.

**5.331** The key characteristics of DIICCSRTE's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the large growth in staff in 2011–12, including in state offices, as a result of the transfer of the tertiary, skills and international (TSI) functions from the Department of Employment Education and Workplace Relations (DEEWR) as part of the Administrative Arrangements Order (AAO) dated 14 December 2011;
- the transitional arrangements established to assist with the integration of the climate change functions into the department;
- the reliance on third parties for processing a number of items including DEEWR, which has maintained some of the processing and IT platforms for items transferred under the AAO;
- the number and complexity of administered programs. The number and extent of programs is also changing as a result of new government initiatives and the winding down of existing programs; and
- the holding of large receivables relating to the Higher Education Loan Program and provisions, such as the provision for unfunded university superannuation, required to be valued at fair value, which are subject to a number of complex valuation issues.

**5.332** In the light of these characteristics and the ANAO's understanding of the operations of DIICCSRTE, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.333 DIICCSRTE's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	559	402		
Revenue from government	503	359		
Administered income			1 298	1 565
Administered expenses			16 608	13 378
Total assets	514	413	29 249	26 160
Total liabilities	203	184	7 867	7 741

DIICCSRTE's estimated average staffing level for 2012–13 is 3 449 (2011–12: 2 555).

## Governance arrangements

5.334 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DIICCSRTE's business objectives. These arrangements are designed to support DIICCSRTE's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.335 The key elements of DIICCSRTE's corporate governance arrangements include:

- a strategic plan that provides an overview of DIICCSRTE's future directions;
- regular meetings of the Secretary and senior managers to discuss key aspects of DIICCSRTE activities, including program management and financial performance;
- a structured framework for incorporating risk management into the broader management and business processes, including the development and maintenance of a fraud control plan;
- an audit committee that meets bi-monthly and focuses on the enhancement of the control framework and risk management arrangements to improve the objectivity and reliability of externally published financial and other information;

- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports; and
- an internal audit function that addresses key business and financial risks and aims to assist line areas meet their key objectives.

## Areas of audit focus

5.336 In the light of the ANAO's understanding of DIICCSRTE's environment and governance arrangements, which includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DIICCSRTE's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the actuarial valuation of Higher Education Loan Program (HELP) receivables due to the complexity involved in projecting future payments and/or potential non repayment of loans;
- the actuarial valuation of the provision for grants relating to unfunded superannuation commitments for Australian universities. These estimates are complex due to calculation timings and different actuarial assumptions used for each relevant state;
- the TSI systems transferred to DIICCSRTE in 2011–12, as responsibility for these systems is shared between DIICCSRTE and DEEWR;
- the transitional arrangements in place relating to the climate change functions transferred to DIICCSRTE; and
- legislative compliance, particularly the implementation of measures designed to address the risk of a breach of section 83 of the Constitution, referred to in the 2011–12 financial statements.

5.337 As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DIICCSRTE's financial statements.

## Audit results

5.338 The ANAO completed the interim phase of the financial statements audit in accordance with the audit strategy communicated to DIICCSRTE. The

interim audit phase has not included coverage of the climate change functions. These will be reviewed as part of the 2012–13 final audit phase.

**5.339** No new significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of areas of audit focus to date.

**5.340** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

**Status of audit issues raised by the ANAO**

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	1*	0	0	1
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>0</b>	<b>0</b>	<b>2</b>

\* This issue relates to a finding transferred from the former DCCEE in relation to privileged user access.

*Outstanding moderate audit issue*

Privileged user access

**5.341** During the 2011–12 audit of the former DCCEE, the ANAO identified the need for improvements in monitoring privileged user access to that department’s FMIS. This system continues to be used and is now the responsibility of DIICCSRTE. At the date of this report, the audit finding was being investigated, including consideration of whether the systems of the former DCCEE will continue to operate once the functions of the former DCCEE are fully transitioned to DIICCSRTE.

*Potential breaches of section 83 of the Constitution*

**5.342** During 2011–12, the then Department of Industry, Innovation, Science, Research and Tertiary Education (DIISRTE) became aware of the possibility of potential breaches of section 83 of the Constitution for payments made from special appropriations and special accounts, particularly in circumstances where the payments do not accord with conditions included in the relevant legislation.

**5.343** DIISRTE undertook a review to determine the risk of payments being made in breach of section 83 from the special appropriations and special

accounts for which it was administratively responsible. This assessment was undertaken for all relevant payments with the exception of payments made pursuant to the *Social Security (Administration) Act 1999*.

**5.344** A risk assessment was not completed for the *Social Security (Administration) Act 1999* payments due to the number of preconditions included in the legislation, and the volume of transactions involved. Consequently, as part of the 2011–12 financial statements, DIISRTE determined that the debts raised under the Act were potential breaches of section 83 of the Constitution. In 2012–13, DIICCSRTE advised that it intended to adopt the approach followed by DIISRTE in 2011–12 and report *Social Security (Administration) Act 1999* payments as potential section 83 breaches rather than investigating individual payments for compliance against the legislative requirements.

**5.345** At the time of this report, DIICCSRTE was finalising its review in relation to certain payments. The outcome of this review will be assessed as part of the 2012–13 final audit phase.

**5.346** DIICCSRTE has undertaken to monitor its level of section 83 compliance across all other legislation for which it is administratively responsible. Where possible, amendments to legislation will continue to be progressed.

## **Conclusion**

**5.347** Based on our audit coverage to date, the ANAO identified that key elements of internal control, except for the issue referred to above, were operating effectively to provide reasonable assurance that DIICCSRTE will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Infrastructure and Transport Portfolio

---

## Department of Infrastructure and Transport

**5.348** The Department of Infrastructure and Transport (Infrastructure) provides policy advice, targeted research, and a range of programs that include investment in infrastructure, transport security, surface transport, road safety, and air transport. The department also provides resources to assist Infrastructure Australia and the International Air Services Commission in the performance of their functions.

**5.349** Infrastructure's responsibilities include:

- delivering the nation building infrastructure investment programs;
- implementation of national ports and freight strategies, shipping industry reforms, maritime safety, rail and aviation capacity;
- working with the states and territories to establish single national regulators for maritime safety, rail safety, and heavy vehicles;
- implementing National Urban Policy and State of Australian Cities reporting; and
- managing threats to transport security.

**5.350** The key characteristics of Infrastructure's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the large number and complexity of the grant and subsidy programs administered by the department; and
- the significant administered asset balances reported in Infrastructure's financial statements in respect of the Australian Government's investment in portfolio agencies.

**5.351** In the light of these characteristics and the ANAO's understanding of Infrastructure's operations, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as low.

## Financial overview

5.352 Infrastructure's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	192	205		
Revenue from government	181	192		
Administered income			1 187	2 486
Administered expenses			1 939	3 306
Total assets	134	139	4 623	4 412
Total liabilities	79	80	26	27

Infrastructure's estimated average staffing level for 2012–13 is 1 000 (2011–12: 984).

## Governance arrangements

5.353 Infrastructure has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of its business objectives. These arrangements are designed to support Infrastructure's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.354 The key elements of Infrastructure's corporate governance arrangements include:

- an executive management group that meets weekly, addresses strategic issues, monitors Infrastructure's financial performance and oversees the operational performance of divisions;
- a governance committee framework, including an audit committee that meets regularly and focuses attention on internal control, management of risks, review of financial reports, control of public monies and regulatory compliance;
- an internal audit function that addresses key business and financial risks and contributes to meeting Infrastructure's key objectives;
- a fraud control plan that is in line with the Commonwealth Fraud Control Guidelines;



- a Certificate of Compliance regime which forms a key part of Infrastructure's corporate governance and compliance framework;
- a framework for incorporating risk management into Infrastructure's broader management and business processes; and
- a financial reporting framework that involves monitoring the performance and financial management of key business areas, and the preparation and monitoring of monthly financial reports.

### **Areas of audit focus**

**5.355** In the light of the ANAO's understanding of Infrastructure's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Infrastructure's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the financial management and reporting of grant and subsidy programs which represent a significant portion of the department's administered expenses;
- significant judgements and estimates used in determining the value of administered investments, employee provisions, leasehold improvements and associated make good obligations; and
- Infrastructure's quality assurance review process relating to the financial statements.

**5.356** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of Infrastructure's financial statements.

### **Audit results**

**5.357** The ANAO's interim audit activity has focussed on the financial management and reporting of grant and subsidy programs, areas involving significant judgements and estimates, and IT general and application controls as they relate to the financial statements.

**5.358** The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

5.359 To date, our audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

5.360 The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

**Status of audit issues raised by the ANAO**

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)*	0	0	0	0	0
L1	0	0	1	1	(1)**	0	0
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>1</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>

\* The category B issue relating to quality assurance review over the financial statements was downgraded to a category C finding in 2011–12.

\*\* The potential breach in 2011–12 relates to section 83 of the Constitution. The finding is considered to be resolved on the basis that the risk of breaches in 2012–13 has been assessed as low.

*Prior year moderate audit issue*

5.361 The 2010–11 interim audit identified that the financial statement preparation process could be improved by strengthening quality assurance and review procedures and further application of project management practices that facilitate more timely identification and communication of any delays in the preparation process.

5.362 At the conclusion of the 2011–12 audit, the ANAO reported that Infrastructure’s quality assurance review processes over the financial statements had improved sufficiently to justify downgrading the finding to a category C finding.

5.363 The 2012–13 interim audit phase identified that the department has in place a financial statements preparation plan to help ensure further improvements are achieved in relation to the preparation of the 2012–13 financial statements.

*Legislative breaches*

5.364 There were no actual legislative breaches reported at the conclusion of the 2011–12 final audit phase, however potential breaches were reported by Infrastructure as indicated below. No new actual or potential legislative breaches have been identified to date in 2012–13.

### *Potential breaches of section 83 of the Constitution*

**5.365** In 2011–12, Infrastructure made payments totalling \$1 079 285 from a special appropriation contained in the *Australian Maritime Safety Authority Act 1990*, that were potentially in breach of section 83 of the Constitution.

**5.366** Legislative changes contained in the *Financial Framework Legislation Amendment Act (No.2) 2012* have been made so that, in the future, the transfer of such payments to AMSA will be appropriated under section 48 of the *Australian Maritime Safety Authority Act 1990*. The ANAO has reviewed Infrastructure's risk assessment, follow-up work and legislative solution and found these to be appropriate.

### **Conclusion**

**5.367** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Infrastructure will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Prime Minister and Cabinet Portfolio

---

## Department of the Prime Minister and Cabinet

**5.368** The principal functions of the Department of the Prime Minister and Cabinet (PM&C) are to provide policy advice and support to the Prime Minister, the Cabinet and portfolio ministers and parliamentary secretaries, and to achieve a coordinated and innovative approach to the development and implementation of government policies.

**5.369** PM&C's business operations include:

- ensuring that policy proposals provided to the Prime Minister, other ministers in the portfolio, and to Cabinet are developed in a coherent, informed and coordinated fashion;
- the coordination and monitoring of the implementation and delivery of Australian Government decisions, policies and priorities, where appropriate;
- supporting the Prime Minister and the Government in managing the business of government in an efficient, effective and coordinated manner;
- providing administrative support to the Prime Minister, the Cabinet Secretary, the Cabinet and its committees; and
- coordinating and facilitating government administration, intergovernmental relations and communications with State and Territory Governments.

**5.370** The key characteristics of PM&C's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the relatively non-complex nature of PM&C's IT systems; and
- the overall effectiveness of PM&C's internal controls.

**5.371** The ANAO's understanding of the operations of PM&C, and its prominence in relation to government policy-setting and coordination, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.372 PM&C's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	127	182		
Revenue from government	121	171		
Administered income			0	3
Administered expenses			15	616
Total assets	63	67	3	3
Total liabilities	40	39	14	15

PM&C's estimated average staffing level for 2012–13 is 698 (2011–12: 880).

## Governance arrangements

5.373 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of PM&C's business objectives. These arrangements are designed to support PM&C's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.374 The key elements of PM&C's corporate governance arrangements include:

- an executive group comprising the Secretary and Associate and Deputy Secretaries. The group considers strategic issues that impact on PM&C and also monitors the department's performance and budget in delivering the department's outcomes;
- a senior management group that meets regularly to discuss key business issues for PM&C, including business priorities and key commitments. The group comprises the executive group and division heads;
- an audit committee that is chaired by the Deputy Secretary, Governance and meets quarterly. The audit committee is responsible for overseeing the department's approach to risk management, including PM&C's overall control framework;

- an internal audit function that plans and conducts audits based on risk assessments of departmental activities and direction from the audit committee;
- a risk management framework and plan that identifies and assists in the management of risk at the strategic, business and project level;
- a fraud policy statement and fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines; and
- a governance unit that oversees PM&C's governance arrangements.

### **Areas of audit focus**

**5.375** In the light of the ANAO's understanding of PM&C's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on PM&C's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the management and financial reporting of human resource expenditure, given it is material to the financial statements and some minor issues have been reported in the past; and
- the recognition of commitments relating to Australia's hosting of the Group of 20 meeting in 2014.

**5.376** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of PM&C's financial statements.

### **Audit results**

**5.377** The ANAO has commenced its review of internal controls relevant to the preparation of the department's financial statements, including those relating to the management and financial reporting of human resource expenditure.

**5.378** The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.379** No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of the areas of audit focus to date. The 2011–12 audit did not identify any new significant or moderate audit issues.

## **Conclusion**

**5.380** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that PM&C will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Regional Australia, Local Government, Arts and Sport Portfolio

---

## Department of Regional Australia, Local Government, Arts and Sport

**5.381** The Department of Regional Australia, Local Government, Arts and Sport (DRALGAS) supports the Government's commitment to improve the social, economic and environmental outcomes for Australia's regions and to provide oversight and management of the sport, recreation, arts, and culture functions.

**5.382** The principal responsibilities of the department are:

- regional Australia policy and coordination;
- regional development, and the delivery of regional and territory specific services and programs;
- matters relating to local Government, including financial assistance grants to councils and shires;
- planning and land management in the Australian Capital Territory;
- administration of the Jervis Bay Territory, the Territory of Cocos (Keeling) Islands, the Territory of Christmas Island, the Coral Sea Islands Territory, the Territory of Ashmore and Cartier Islands, and the Commonwealth responsibilities for Norfolk Island;
- improved opportunities for community participation in sport and recreation, focussing on: high-performance athletes; initiatives to help protect the integrity of sport; investment in sport infrastructure; coordination of Commonwealth involvement in major sporting events; and research and international cooperation on sports issues;
- cultural affairs, including movable cultural heritage and support for the arts;
- management of government records; and
- effective management of developments in the legislation supporting the Northern Territory and the Australian Capital Territory, consistent with constitutional developments and the national interest.



5.383 The key characteristics of DRALGAS’ business operations that shaped the ANAO’s 2012–13 planned financial statement audit coverage include:

- the operation of shared service arrangements with the Departments of Infrastructure and Transport, and the Prime Minister and Cabinet;
- the geographical spread of operations, including the large number of grant programs administered by the department, diverse revenue items associated with the department’s administration of Australian Government Territories and non-financial assets located in the administered Territories; and
- continuing refinement of the department’s control environment and governance processes in relation to the arts and sports functions which were transferred to the RALGAS portfolio as a result of the Administrative Arrangements Order of 14 December 2011.

5.384 In the light of these characteristics and the ANAO’s understanding of the operations of DRALGAS, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

**Financial overview**

5.385 DRALGAS’ key financial balances are:

Key financial balances	Departmental Estimated (\$m) 2012–13	Departmental Actual (\$m) 2011–12	Administered Estimated (\$m) 2012–13	Administered Actual (\$m) 2011–12
Net cost of services	105	90		
Revenue from government	100	85		
Administered income			47	41
Administered expenses			3 525	3 612
Total assets	203	208	8 892	8 928
Total liabilities	40	49	19	26

DRALGAS’ estimated average staffing level for 2012–13 is 552 (2011–12: 485).

## **Governance arrangements**

5.386 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DRALGAS' business objectives. These arrangements are designed to support DRALGAS' financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.387 The key elements of DRALGAS' corporate governance arrangements include:

- an executive management group that meets fortnightly to address strategic issues, monitor financial performance, and oversee operational and performance issues;
- a governance committee framework, including a risk and audit committee that meets at least quarterly which focuses attention on internal control, management of risks, review of financial reports, control of public monies and regulatory compliance;
- a financial statements sub-committee of the risk and audit committee that provides advice regarding the preparation and certification of the financial statements;
- a fraud control plan and a financial statements risk plan;
- a risk management framework and plan that identifies and assists the management of risk at various levels of the department; and
- an internal audit function that provides a risk based coverage of the department's activities.

## **Areas of audit focus**

5.388 In the light of the ANAO's understanding of DRALGAS' environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DRALGAS' financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the effectiveness of internal controls designed to ensure the accurate and complete processing of transactions undertaken by the Departments of Infrastructure and Transport, and the Prime Minister

and Cabinet on behalf of DRALGAS, in accordance with shared services arrangements with those agencies;

- control activities and financial reporting arrangements in respect of areas which are particularly significant to the financial statements including large grant programs administered by the department and non-financial assets held in dispersed locations; and
- the completeness of administered revenue in view of the decentralised activities administered by the department across regional Australia.

**5.389** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DRALGAS' financial statements.

## **Audit results**

**5.390** The ANAO's 2012–13 interim audit phase has focussed on testing internal controls relating to the financial management and reporting of grants and the shared service arrangements with the Departments of Infrastructure and Transport and the Prime Minister and Cabinet.

**5.391** The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.392** No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of the areas of audit focus to date. The 2011–12 audit did not identify any significant audit issues.

## **Conclusion**

**5.393** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DRALGAS will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Resources, Energy and Tourism Portfolio

---

## Department of Resources, Energy and Tourism

**5.394** The Department of Resources, Energy and Tourism (RET) is responsible for enhancing Australia's economic prosperity by improving the productivity, competitiveness, security and sustainability of the resources, energy and tourism sectors. RET pursues these objectives by providing policy advice and program delivery services for the Australian Government.

**5.395** Machinery of Government (MoG) changes, which took effect on 25 March 2013, involved the energy efficiency function being transferred to RET from the former Department of Climate Change and Energy Efficiency.

**5.396** RET's strategic directions are structured around four key areas: strategic policy development; enhancing productivity and international competitiveness; enhancing environmental and social sustainability; and enhancing national security.

**5.397** RET's business operations include:

- providing advice to the Australian Government on the impact of policies in the resources, energy and tourism sectors; and
- developing policies and the delivery of programs to provide resources, energy and tourism related initiatives.

**5.398** The key characteristics of RET's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the management of a large number of administered programs; and
- the department's responsibility for the collection of petroleum and uranium royalties. These royalty collections are generally managed by other government jurisdictions on behalf of RET.

**5.399** In the light of these characteristics and the ANAO's understanding of the operations of RET, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.400 RET's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	118	120		
Revenue from government	117	115		
Administered income			1 962	1 702
Administered expenses			586	700
Total assets	98	41	941	984
Total liabilities	51	39	11	6

RET's estimated average staffing level for 2012–13 is 516 (2011–12: 551). The 2012–13 figure represents the part year effect of the Machinery of Government changes of 25 March 2013. The full year average staffing level equivalent for 2012–13 is 680.

## Governance arrangements

5.401 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of RET's business objectives. These arrangements are designed to support RET's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.402 The key elements of RET's corporate governance arrangements include:

- an Executive Board that meets regularly to discuss key aspects of RET activities, including program management and financial performance;
- a structured framework for incorporating risk management into the broader management and business processes, including the development and maintenance of a fraud control plan;
- an audit committee that meets quarterly and focuses on the department's control framework and risk management arrangements to improve the objectivity and reliability of externally published financial and other information; and
- an internal audit function that examines key business and financial risks to assist line areas to meet their key objectives.

## Areas of audit focus

**5.403** In the light of the ANAO's understanding of RET's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on RET's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the valuation of the Commonwealth's investment in the Snowy Hydro Limited (SHL) that is recognised as an administered investment in RET's financial statements, in light of the complexity and volatility of the valuation and its material impact on the financial statements;
- revenue relating to petroleum royalties, given the volatility of the revenue streams that are generally managed by other government jurisdictions on behalf of RET and their material impact on the financial statements; and
- the accounting for MoG changes by the department with the transfer of the energy efficiency function from the former Department of Climate Change and Energy Efficiency.

**5.404** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of RET's financial statements.

## Audit results

**5.405** The ANAO has commenced a review of the internal controls at the interim audit phase relevant to the preparation of the department's financial statements. The ANAO has also commenced work in relation to the areas of audit focus identified above.

**5.406** To date, audit coverage of areas of audit focus has not identified any new significant or moderate audit issues. RET is considering the impact of the MoG changes on its operations. The ANAO will review the impact of these MoG changes, in addition to the other areas of audit focus during the 2012–13 final audit phase.

**5.407** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

## Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	0	0
L1	0	0	1	1	(1)*	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>

\* The breach in 2011–12 relates to section 83 of the Constitution. The finding is considered to be resolved on the basis that the risk of breaches in 2012–13 has been assessed as low.

### Resolved audit issue

#### Actual breaches of section 83 of the Constitution

**5.408** In 2011–12, RET undertook to address the risk of breaches of section 83 of the Constitution for payments made from special appropriations and special accounts, particularly in circumstances where the payments did not accord with conditions included in the relevant legislation.

**5.409** During 2011–12, the department finalised its review of the special appropriations and special accounts for which it is administratively responsible. The risk assessment and subsequent analysis to 30 June 2012 identified six breaches of section 83 totalling \$0.6 million as a result of amendments to the *Offshore Petroleum and Greenhouse Gas Storage Act 2006*. Remedial action was not required given the appropriation is no longer utilised. The risk of payments from other special appropriations being in breach of section 83 was assessed by RET as low. The risk assessments performed in 2011–12 will be reconsidered in 2012–13 and reviewed by the ANAO in the final audit phase.

### Conclusion

**5.410** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that RET will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Sustainability, Environment, Water, Population and Communities Portfolio

---

## Department of Sustainability, Environment, Water, Population and Communities

**5.411** The Department of Sustainability, Environment, Water, Population and Communities (DSEWPaC) provides policy advice and administers programs to achieve the Government's objectives in the areas of the environment, water availability, heritage and culture, as well as the development of the sustainable population strategy. DSEWPaC is also responsible for supporting Australia's Antarctic activities.

**5.412** DSEWPaC's business operations include:

- conserving and protecting Australia's terrestrial and marine biodiversity and ecosystems, through supporting research, developing information, supporting natural resource management, and establishing and managing Commonwealth protected areas;
- improving the sustainability of Australia's population, communities and environment through the coordination and development of sustainable population and communities' policies, and the reduction and regulation of waste, pollutants and hazardous substances;
- advancing Australia's strategic, scientific, environmental and economic interests in the Antarctic by protecting, administering and researching the Antarctic region;
- developing strategies in relation to climate change including wise water use, securing water supplies and improving health of rivers, waterways and freshwater ecosystems by supporting research, and reforming the management and use of water resources;
- increasing protection, awareness and appreciation of Australia's environment and heritage through regulating matters of national environmental significance and the identification, conservation and celebration of natural, indigenous and historic places of national and World Heritage significance; and
- protecting and restoring environmental assets through the management and use of water assets held by the Commonwealth.



**5.413** The key characteristics of DSEWPaC's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- significant administered asset balances, particularly the Australian Government's investments in water assets, reported in DSEWPaC's financial statements;
- the significant and diverse grant programs administered by DSEWPaC;
- the ongoing management of Australia's Antarctic bases, including management's estimate of the cost to restore the bases; and
- the introduction of a carbon price equivalent on synthetic greenhouse gases, including the completeness and accuracy of revenue collections.

**5.414** In the light of these characteristics and the ANAO's understanding of the operations of DSEWPaC, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

**5.415** DSEWPaC's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	509	595		
Revenue from government	436	466		
Administered income			135	78
Administered expenses			749	888
Total assets	469	510	3 199	3 045
Total liabilities	558	552	42	42

DSEWPaC's estimated average staffing level for 2012–13 is 2 291 (2011–12: 2 233).

## Governance arrangements

**5.416** The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of DSEWPaC's business objectives. These arrangements are designed to support DSEWPaC's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.417** The key elements of DSEWPaC's corporate governance arrangements include:

- a strategic plan that provides an overview of DSEWPaC's strategic priorities and goals, including the department's planning and performance framework;
- a management board, which comprises the Secretary and Deputy Secretaries, that meets regularly to evaluate DSEWPaC's strategic direction, financial planning and operational results;
- an audit committee that includes four independent members including the chair. The audit committee meets regularly and focuses on risk management, the control environment, a review of financial reports and DSEWPaC's compliance with laws and regulations;
- a framework for incorporating risk management into the broader management and business processes including the development of a fraud control plan; and
- an internal audit function that plans and conducts audits based on a risk assessment of departmental activities.

### **Areas of audit focus**

**5.418** In the light of the ANAO's understanding of DSEWPaC's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DSEWPaC's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the methodology used by DSEWPaC to value the water assets it holds on behalf of the Commonwealth;
- the model adopted by DSEWPaC to estimate their obligation to restore the Antarctic bases, particularly the appropriateness of assumptions used;
- the financial management and reporting of grants, including those related to the Caring for Our Country program and the Sustainable Rural Water Use and Infrastructure program; and

- the revenue collections associated with the recently introduced carbon price equivalent on the importation and manufacturing of synthetic greenhouse gases.

**5.419** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of DSEWPaC's financial statements.

## **Audit results**

**5.420** The ANAO's 2012–13 interim audit phase has focussed on testing internal control relating to the financial management and reporting of grants and the management of the Commonwealth's water assets.

**5.421** The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.422** No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of the areas of audit focus to date. The 2011–12 audit did not identify any new significant or moderate audit issues.

## **Conclusion**

**5.423** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DSEWPaC will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

# Treasury Portfolio

---

## Department of the Treasury

**5.424** The Department of the Treasury (the Treasury) is the primary advisory body to the Australian Government on economic policy and development. The Treasury develops and implements policies to improve the wellbeing of the Australian people, by achieving strong, sustainable economic growth, through the provision of advice to the Australian Government and the efficient administration of federal financial relations.

**5.425** The Treasury's business operations include:

- supporting a sound macroeconomic environment through monitoring and assessing economic conditions and prospects, both in Australia and overseas;
- providing advice on the formulation and implementation of effective macroeconomic policy, including monetary and fiscal policy, and labour market issues;
- providing advice on budget policy issues, trends in Commonwealth revenue and major fiscal and financial aggregates, major expenditure programs, taxation policy, retirement income, Commonwealth-State financial policy and actuarial services;
- addressing effective taxation and retirement income arrangements through the provision of advice, and assisting in the formulation and implementation of government taxation and retirement income policies and legislation as well as providing information on material changes to taxation revenue forecasts and projections; and
- providing advice on policy processes and reforms that promote a secure financial system and sound corporate practices, removing impediments to competition in product and services markets and safeguarding the public interest in matters such as consumer protection and foreign investment.

**5.426** The key characteristics of the Treasury's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the Council of Australian Governments (COAG) federal financial relations framework reflected in the *Federal Financial Relations Act 2009*. Under this framework, individual agencies have policy responsibility for the performance of programs and advise the Treasury of details of specific purpose payments and amounts payable to the States and Territories under National Partnership Agreements;
- the complexity of the Treasury's legislation and the risk of non compliance with relevant aspects of the Commonwealth's financial framework;
- the Treasury's responsibility for monitoring the guarantees of deposits and wholesale funding and the temporary and voluntary guarantees over State and Territory Government borrowings that were first put in place following the global financial crisis. From 31 March 2010 no new wholesale funding arrangements have been entered into and, from 31 December 2010, the Australian Government guarantee of State and Territory borrowings closed to new issuance of guaranteed liability; and
- the Treasury's responsibility for managing investments in overseas financial institutions and the impact of the increased volatility affecting overseas markets, particularly in Europe.

**5.427** In the light of these characteristics and the ANAO's understanding of the operations of the Treasury, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

5.428 The Treasury's key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012-13	2011-12	2012-13	2011-12
Net cost of services	186	183		
Revenue from government	174	158		
Administered income			2 854	5 758
Administered expenses			81 138	86 868
Total assets	86	104	14 783	15 245
Total liabilities	51	49	14 126	13 590

The Treasury's estimated average staffing level for 2012-13 is 937 (2011-12: 1 007).

## Governance arrangements

5.429 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of the Treasury's business objectives. These arrangements are designed to support the Treasury's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.430 The key elements of the Treasury's corporate governance arrangements include:

- an Executive Board that meets at least monthly and is responsible for high level policy issues relating to the Treasury's strategic leadership and management;
- a committee framework including an audit committee that meets at least six times a year and focuses attention on corporate governance, internal audit, external audit, fraud and risks faced by the Treasury;
- a comprehensive and coordinated framework for incorporating risk management into broader management and business processes;
- an internal assurance function that has a planned risk based coverage of the Treasury's activities; and
- a periodic fraud risk assessment undertaken in line with the Commonwealth Fraud Control Guidelines.

## Areas of audit focus

**5.431** In the light of the ANAO's understanding of the Treasury's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on the Treasury's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the recognition and measurement of grant payments under the federal financial relations framework, as reflected in the *Federal Financial Relations Act 2009*, due to the Treasury's reliance on information provided by third parties, particularly other agencies;
- the methodology used to estimate the provision for the Natural Disaster Relief and Recovery Arrangements (NDRRA) due to the complex estimation process; and
- compliance with relevant aspects of the Commonwealth's financial framework and the implementation of measures designed to address the risk of a breach of section 83 of the Constitution referred to in the 2011–12 financial statements.

**5.432** The ANAO will continue to provide audit coverage of the following areas which have previously been identified as having a significant impact on the financial statements:

- the Treasury's administration of the guarantees of deposits and wholesale funding and the temporary and voluntary guarantees over State and Territory Government borrowings; and
- the valuation of the Treasury's financial investment in international financial institutions, in light of increased volatility experienced in overseas markets.

**5.433** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of the Treasury's financial statements.

## Audit results

**5.434** The ANAO's interim audit phase coverage to date has included a review of the controls relating to grants processing, including controls over the assessment of grant eligibility and the grant payment process. The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.435** To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

**5.436** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	3	(3)	0	0	0	0	0
L1	0	0	1	1	0	0	1
<b>Total</b>	<b>3</b>	<b>(3)</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>

### Potential breaches of section 83 of the Constitution

**5.437** The 2011–12 financial statements made reference at note 29, to a number of potential breaches of section 83 of the Constitution. The potential breaches related to three groups of payments totalling \$4.3 million, which comprised a very small percentage of the approximately \$86 billion in payments made during the year. At the date of completing the 2012–13 interim audit, the Treasury was still to receive legal advice in respect of similar payments made in 2012–13.

**5.438** The Treasury is continuing to monitor its level of section 83 compliance across all legislation for which it is administratively responsible. Where possible, amendments to legislation will continue to be progressed by the department.

**5.439** The ANAO will review progress in addressing this issue as part of the 2012–13 final audit phase.



## Conclusion

**5.440** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the Treasury will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

## Australian Office of Financial Management

**5.441** The Australian Office of Financial Management (AOFM) is responsible for the management of Australian Government debt and financial assets. The AOFM issues treasury bonds, treasury indexed bonds and treasury notes, manages the Australian Government's cash balances and invests in financial assets. Over the years, the Government has issued treasury bonds to maintain liquid and efficient bond and bond futures markets, reflecting the important role that these markets play in the Australian financial system.

**5.442** The AOFM's business operations include:

- funding the Australian Government's budget, to the extent required, through the issuance of Australian Government debt;
- managing the Australian Government's daily cash balances through short term borrowings and investments;
- undertaking investments in financial assets in accordance with government policy objectives;
- managing its portfolio of debt and financial assets cost effectively, subject to acceptable risk; and
- supporting the efficient operation of Australia's financial system.

**5.443** The key characteristics of the AOFM's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- the volume of investment activity of financial assets and issuance of financial liabilities, that are material to both the agency and the Consolidated Financial Statements;
- a continuation of the issuance of treasury indexed bonds to meet the Government's funding requirements; and
- material and complex financial assets and liabilities and their associated fair value assessment.

**5.444** In the light of these characteristics and the ANAO’s understanding of the operations of the AOFM, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as moderate.

## Financial overview

**5.445** The AOFM’s key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	10	9		
Revenue from government	11	12		
Administered income			1 116	1 413
Administered expenses			12 210	11 421
Total assets	29	27	29 648	28 118
Total liabilities	2	2	292 852	269 785

The AOFM’s estimated average staffing level for 2012–13 is 41 (2011–12: 39).

## Governance arrangements

**5.446** The AOFM has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of the agency’s business objectives. These arrangements are designed to support the AOFM’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.447** The key elements of the AOFM’s corporate governance arrangements include:

- an advisory board accountable to the Secretary of the Department of the Treasury that meets quarterly and provides general counsel and guidance on debt management policy, operational strategy and the performance of the AOFM;
- a governance committee framework, including an audit committee which focuses attention on internal and external audit; fraud control and the statutory financial statements. Other committees include:

- an Executive Committee that coordinates the overall management of the agency, including the consideration of strategic issues; coordination of priorities, financial management, organisational arrangements and resource management;
  - an Asset and Liability Committee that advises the Chief Executive Officer on operational debt policy and financial management issues; and
  - an Information Technology Steering Committee that oversees current and planned information technology projects and operations.
- an internal audit function that provides a risk based coverage of the AOFM's activities;
  - a framework for incorporating risk management into the AOFM's broader management and business processes; and
  - a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

### Areas of audit focus

5.448 In the light of the ANAO's understanding of the AOFM's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on the AOFM's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the complex fair value measurement of financial assets and liability securities;
- financial instrument presentation and disclosures, including the impact of AASB 7 *Financial Instruments: Disclosures* fair-value hierarchy and changes to AASB 139 *Financial Instruments: Recognition and Measurement*; and
- legislative compliance, particularly the implementation of measures designed to address the risk of breaches of section 83 of the Constitution.

**5.449** The ANAO will continue to provide audit coverage of the following areas which have previously been identified as having a significant impact on the financial statements:

- the control environment and the establishment of adequate controls to enable compliance with aspects of relevant financial management legislation;
- the AOFM's management and control framework around the issuance of debt instruments including treasury bonds, treasury indexed bonds and treasury notes; and
- internal assurance activities, including the Certificate of Compliance process, and fraud prevention activities.

**5.450** As an integral part of the interim audit phase, the ANAO has reviewed the IT general and application controls for key systems that support the preparation of the AOFM's financial statements.

## **Audit results**

**5.451** The areas of financial instruments and fair value measurements, including presentation and disclosures in the financial statements, will be reviewed as part of the 2012–13 final audit phase.

**5.452** No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of the areas of audit focus to date. The 2011–12 audit did not identify any new significant or moderate audit issues.

## **Conclusion**

**5.453** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the AOFM will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

## **Australian Taxation Office**

**5.454** The Australian Taxation Office (ATO) is the Australian Government's principal revenue collection agency. In 2012–13, the ATO is expected to raise \$321 billion in revenue, representing approximately 89 per cent of the Australian Government's revenue.

**5.455** The ATO's responsibilities include:

- administration of Australia's taxation, excise and superannuation systems that help fund public goods and services giving effect to economic and social policy and secure retirement income for Australians;
- protecting Australia's revenue system by deterring, detecting and dealing with those who have not complied with their taxation obligations;
- supporting delivery of government benefits to the community including private health insurance, family assistance and fuel grants schemes;
- providing cross agency support by exchanging information, data matching, withholding taxation refunds on behalf of other agencies and supporting whole-of-government initiatives in taxation law enforcement;
- maintaining the Australian Business Register that makes it easier for businesses and all levels of government to interact;
- the provision of valuation services to the government sector through the Australian Valuation Office; and
- registering charities, public benevolent institutions and not-for-profit organisations for Commonwealth purposes through the Australian Charities and Not-for-profits Commission.

**5.456** The key characteristics of the ATO's business operations that shaped the ANAO's 2012–13 planned financial statement audit coverage include:

- a voluntary self assessment regime for the collection of taxation revenues;
- a complex financial statement process that involves using data from a number of business systems and the calculation of estimates for balances of a number of financial statement items;
- valuation of the taxation receivables, particularly the estimation of the collectability of outstanding tax debts; and
- extensive IT-based business systems and associated processes.

5.457 In the light of these characteristics and the ANAO’s understanding of the operations of the ATO, the ANAO has assessed, for the purposes of planning the audit coverage for 2012–13, the risk of a material misstatement as high.

## Financial overview

5.458 The ATO’s key financial balances are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m)	(\$m)	(\$m)	(\$m)
	2012–13	2011–12	2012–13	2011–12
Net cost of services	3 386	3 343		
Revenue from government	3 249	3 131		
Administered income			320 565	307 537
Administered expenses			16 302	15 084
Total assets	1 314	1 245	30 126	28 416
Total liabilities	1 228	1 212	8 350	7 451

The ATO’s estimated average staffing level for 2012–13 is 21 514 (2011–12: 21 864).

## Governance arrangements

5.459 The ATO has designed and implemented governance arrangements, a financial reporting regime and an internal control system to enable the achievement of the ATO’s business objectives. These arrangements are designed to support the ATO’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.460 The key elements of the ATO’s corporate governance arrangements include:

- a strategic statement and plan that provide an overview of the ATO’s directions for the future, including corporate outcomes and performance measures. The ATO implements strategies through a comprehensive planning process based on the ATO’s corporate priorities;
- a well defined structure of governance committees and forums that includes an executive committee, an audit committee and an annual plenary governance forum;

- an internal audit function, which provides an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas to meet their key objectives;
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and the Commissioner's annual Certificate of Compliance;
- a framework for incorporating risk management into the ATO's broader management and business processes; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

### **Areas of audit focus**

**5.461** In the light of the ANAO's understanding of the ATO's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on the ATO's financial statements. Areas highlighted for specific audit coverage in 2012–13 are:

- the compliance programs in relation to the collection of taxation revenues, especially the ATO's risk management approach to compliance activities in a self-assessment and voluntary compliance regime;
- complex estimation and allocation processes associated with the reporting of taxation revenue, that involve the application of significant judgement and specialist knowledge;
- processes for estimating the impact of tax debt collectability on the amount included as taxation receivable balance at year end; and
- the ATO's reliance on IT business systems and associated processes, particularly in relation to system interfaces.

**5.462** The ANAO will continue to provide audit coverage over areas that support ATO's operations and are significant to the financial statements, specifically accounting processes related to employees, suppliers, asset management and executive remuneration.

**5.463** As an integral part of the interim audit phase, the ANAO has reviewed the IT general controls over key systems and application controls for the financial management information system that support the preparation of the ATO's financial statements.

## Audit results

**5.464** The ANAO's interim audit phase has focused on ATO's control environment and aspects of the collection and reporting of taxation revenue related to the financial statements.

**5.465** The other areas of audit focus will be completed as part of the 2012–13 final audit phase.

**5.466** To date, audit coverage of the key areas of audit focus has not identified any new significant or moderate audit issues.

**5.467** The following table summarises the status of audit issues reported by the ANAO in 2012–13 and 2011–12.

### Status of audit issues raised by the ANAO

Category	Outstanding findings (at the end of the 2011–12 interim audit)	Resolved findings (at the time of the 2011–12 final audit)	New findings (during the 2011–12 final audit)	Outstanding findings (at the end of the 2011–12 final audit)	Resolved findings (at the time of the 2012–13 interim audit)	New findings (during the 2012–13 interim audit)	Closing position (at the end of the 2012–13 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	0	0
L1	0	0	1*	1	(1)	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>

\* The breaches in 2011–12 relate to section 83 of the Constitution. The finding is considered to be resolved on the basis that the risk of breaches in 2012–13 has been assessed as low.

### Actual breaches of section 83 of the Constitution

**5.468** The 2011–12 financial statements made reference to a number of breaches of section 83 of the Constitution. The note to the financial statements indicates that, from time to time, as a result of processing errors outside the assessment process, incorrect payments are made by the ATO. In these circumstances a payment is made to a taxpayer without any legislative basis, representing a breach of section 83 of the Constitution which requires that no money shall be drawn from the Treasury of the Commonwealth except under an appropriation made by law.



**5.469** To address the risks of further section 83 breaches, the *Financial Framework Legislation Amendment Act (No.2) 2012* made amendments to relevant taxation legislation which enables the Commissioner of Taxation to make overpayments in certain circumstances, with effect from 29 June 2012. For example, overpayments can be made when they are less than the cost of stopping the payment. The amount of the overpayment remains a debt due to the Commonwealth. As a result of these amendments, the risk of future section 83 breaches is low.

## Conclusion

**5.470** Based on audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the ATO will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2012–13 final audit phase.

---



Ian McPhee  
Auditor-General

Canberra ACT  
20 June 2013



# Appendices



## Appendix 1: Agencies covered by this report<sup>48</sup>

Department of Agriculture, Fisheries and Forestry

Attorney–General’s Department

Australian Customs and Border Protection Service

Department of Broadband, Communications and the Digital Economy

Department of Defence

Defence Materiel Organisation

Department of Veterans’ Affairs

Department of Education, Employment and Workplace Relations

Department of Families, Housing, Community Services and Indigenous Affairs

Department of Finance and Deregulation

The Board of Guardians and the Future Fund Management Agency

Department of Foreign Affairs and Trade

Department of Health and Ageing

Department of Human Services

Department of Immigration and Citizenship

Department of Infrastructure and Transport

Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education

Department of the Prime Minister and Cabinet

Department of Regional Australia, Local Government, Arts and Sport

Department of Resources, Energy and Tourism

Department of Sustainability, Environment, Water, Population and Communities

Department of the Treasury

Australian Office of Financial Management

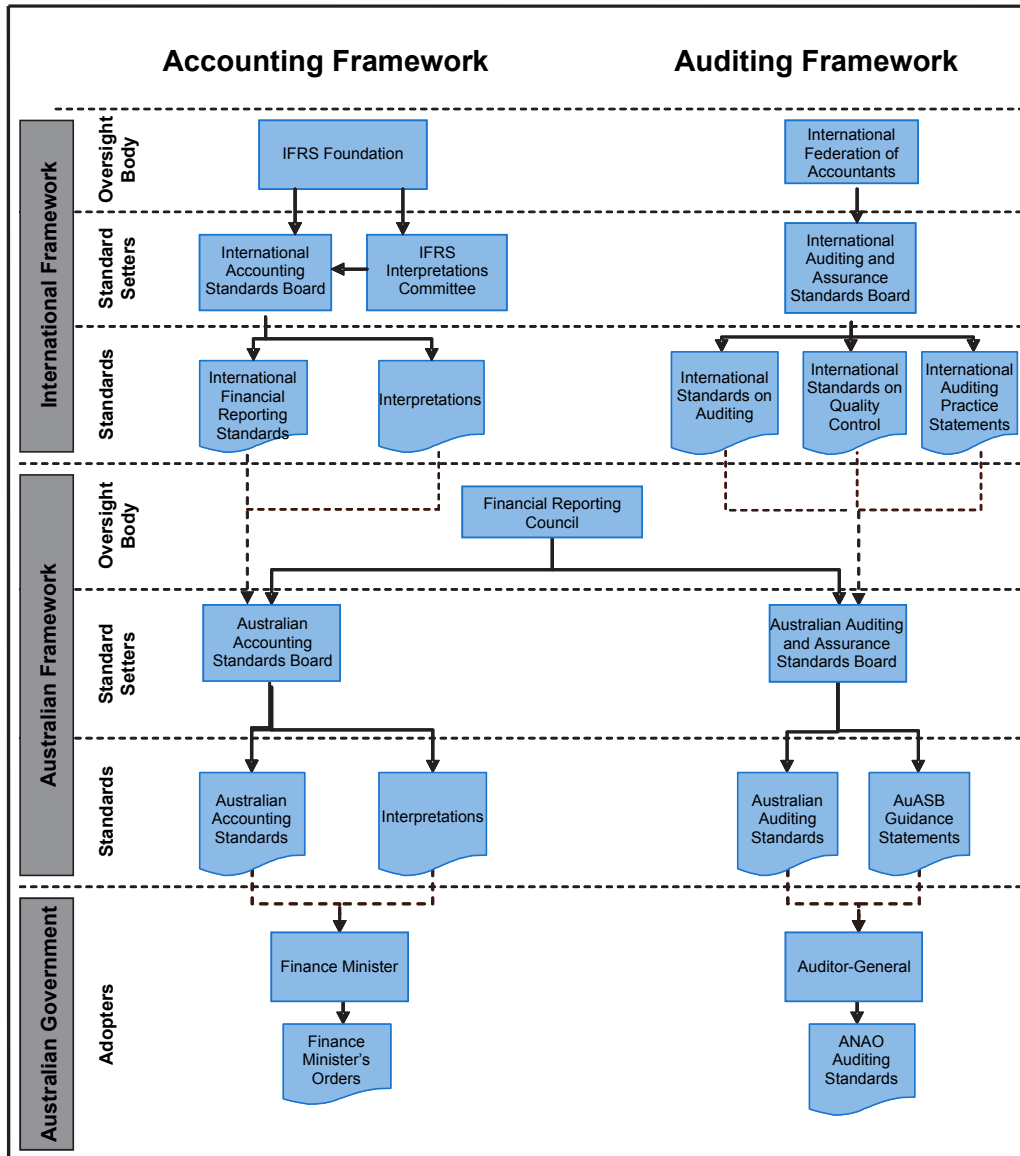
Australian Taxation Office

---

<sup>48</sup> Agencies are grouped by portfolio.

## Appendix 2: The Accounting and Auditing Standards Frameworks

The figure below depicts the standard setting framework, for accounting and auditing, in the Australian Government context.

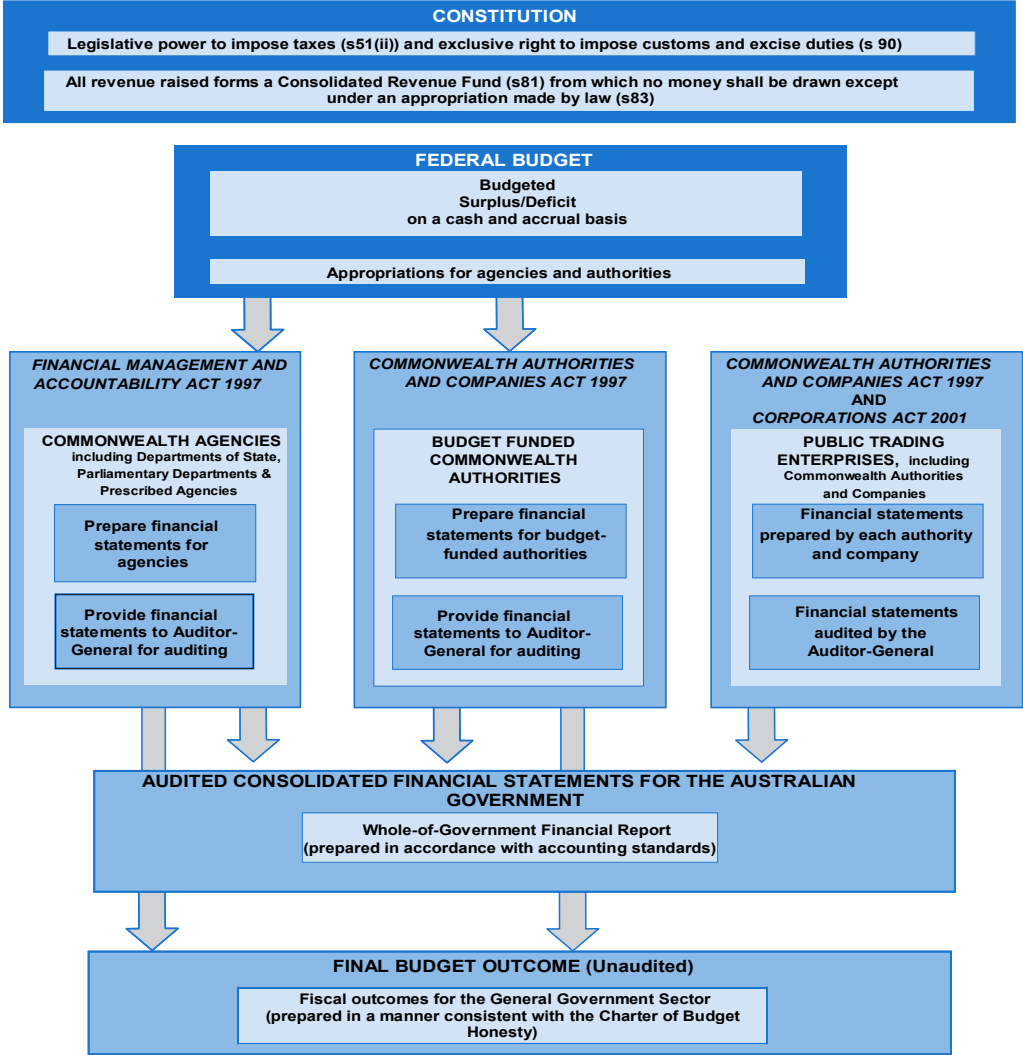


Source: ANAO.

# Appendix 3: The Financial Reporting Framework

Key elements of the Australian Government’s financial reporting framework are outlined in the diagram below. An overview of the financial reporting requirements for the various types of Australian Government entities covered by the framework and the audit approach for the financial statements of these entities is also described below.

## Key Elements of the Financial Reporting Framework



Source: ANAO.

## Australian Government Reporting Entities

### Commonwealth Government of Australia

Section 55 of the 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.

### Australian Government agencies

Australian Government agencies, comprising departments of state, parliamentary departments and prescribed agencies, are subject to the provisions of the FMA Act.

The FMA Act prescribes the FMOs as the applicable financial reporting framework for agencies. The FMOs include a requirement that the financial statements comply with the ASAs issued by the AASB.

### 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. Commonwealth authorities operate under their own enabling legislation and also must comply with relevant provisions of the CAC Act.

The CAC Act prescribes the FMOs as the applicable financial reporting framework for Commonwealth authorities. The financial reporting framework applicable to subsidiaries of Commonwealth authorities depends on the nature of the subsidiary.

### Commonwealth companies and subsidiaries

Commonwealth companies are companies that are controlled by the Australian Government through majority share holdings or voting rights, or via control over the composition of the company's board. Commonwealth companies operate and prepare financial statements under the Corporations Act.

The applicable financial reporting framework for Commonwealth companies is the Corporations Act, including the ASAs and the Corporations Regulations.



The financial reporting framework applicable to subsidiaries of Commonwealth companies depends on the nature of the subsidiary.

### **Other bodies**

The ANAO also audits the financial statements of other bodies under 'by arrangement' provisions in section 20 of the *Auditor-General Act 1997*. These bodies consist primarily of trusts or joint ventures entered into by Commonwealth bodies.

## **Audit of Australian Government entity financial statements**

### **Audit scope**

The Chief Executives of agencies, and the directors of authorities and companies, are responsible for the preparation and presentation of the financial statements and for maintaining records, internal controls, procedures and processes that support the preparation of those statements. The ANAO's independent audits of financial statements are undertaken to form an opinion whether the financial statements are free from material misstatement.

The audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards (ASAs), 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 internal control, 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.

The entity's internal control relevant to the entity's preparation and fair presentation of the financial statements is considered in order to design audit procedures that are appropriate in the circumstances. In some audits, audit procedures concentrate primarily on substantiating the amounts appearing in the financial statements and do not include detailed testing 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 ASAs is designed to provide reasonable assurance that the financial statements, taken as a whole, is free

from material misstatement, whether due to fraud or error. The fact that an audit is carried out may act as a deterrent to fraud. However, the auditor is not responsible for the prevention of fraud and error.

## **The auditor's report on financial statements**

The ANAO auditor's report on the financial statements includes a statement of the auditor's opinion as to whether the financial 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 the applicable financial reporting framework.

If the auditor is not satisfied that the financial statements are true and fair, the auditor's opinion is modified, with the reasons being indicated.

The auditor's report on the financial statements will include the auditor's opinion and may include an 'emphasis of matter' or 'other matters' paragraphs. A report on other legal and regulatory requirements may accompany the auditor's report on the financial statements.

### *Form of auditor's opinion*

An auditor's opinion is described as 'unmodified' when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

An auditor's opinion may be 'modified' in one of three ways.

- A 'modified opinion' is expressed when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in aggregate, are material but not pervasive to the financial statements. A 'modified opinion' is also expressed when the auditor, having been unable to obtain sufficient appropriate audit evidence, concludes that the possible effects on the financial statements of undetected misstatements could be material but not pervasive.
- A 'disclaimer of opinion' is expressed when the auditor, having been unable to obtain sufficient appropriate audit evidence on which to base the opinion, concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.
- An 'adverse opinion' is expressed when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements

individually or in aggregate, are both material and pervasive to the financial statements.

### *Emphasis of matter*

An 'emphasis of matter' paragraph is included in the auditor's report when the auditor considers it necessary to draw to users' attention a matter presented in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to the users' understanding of the financial statements. The auditor's opinion is not modified in respect of the matter emphasised. The circumstances in which an emphasis of matter is used include:

- when material uncertainty exists relating to an event or condition that may cast significant doubt on an entity's ability to continue as a going concern;
- when financial statements and the auditor's report have been issued and a fact is discovered that leads to revised financial statements and a new auditor's report being prepared; and
- when financial statements have been prepared in accordance with a special purpose framework, and as a result the financial statements may not be suitable for another purpose.<sup>49</sup>

### *Other matters*

The auditor's report on the financial statements may also include a reference to 'other matters'. This allows the auditor to communicate a matter other than a matter that is presented or disclosed in the financial statements that, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

### *Report on other legal and regulatory requirements*

The auditor's report on the financial statements may also include a report on other legal and regulatory requirements. This report covers matters that the Auditor-General is required by law to report on in conjunction with the financial statements audit that do not affect the truth and fairness of the financial statements.

For example, section 57 of the FMA Act requires that, where the Auditor-General is of the opinion that a Chief Executive has contravened section 48<sup>50</sup> of

---

<sup>49</sup> Under the ASAs, the Auditor-General is required to include an emphasis of matter where a special purpose framework is adopted. Auditor's reports which include this mandatory requirement have not been included in this report.

the FMA Act, the Auditor-General must state in the auditor's report, the particulars of the contravention.

A report on other legal and regulatory requirements may also be used to draw attention to other legislative issues such as issues relating to agencies' compliance with section 83 of the Constitution.

---

<sup>50</sup> Section 48 of the FMA Act requires the Chief Executive to keep proper accounts and records.

## Series Titles

---

### **ANAO Audit Report No.1 2012–13**

*Administration of the Renewable Energy Demonstration Program*

Department of Resources, Energy and Tourism

### **ANAO Audit Report No.2 2012–13**

*Administration of the Regional Backbone Blackspots Program*

Department of Broadband, Communications and the Digital Economy

### **ANAO Audit Report No.3 2012–13**

*The Design and Conduct of the First Application Round for the Regional Development Australia Fund*

Department of Regional Australia, Local Government, Arts and Sport

### **ANAO Audit Report No.4 2012–13**

*Confidentiality in Government Contracts: Senate Order for Departmental and Agency Contracts (Calendar Year 2011 Compliance)*

Across Agencies

### **ANAO Audit Report No.5 2012–13**

*Management of Australia's Air Combat Capability—F/A-18 Hornet and Super Hornet Fleet Upgrades and Sustainment*

Department of Defence

Defence Materiel Organisation

### **ANAO Audit Report No.6 2012–13**

*Management of Australia's Air Combat Capability—F-35A Joint Strike Fighter Acquisition*

Department of Defence

Defence Materiel Organisation

### **ANAO Audit Report No.7 2012–13**

*Improving Access to Child Care—the Community Support Program*

Department of Education, Employment and Workplace Relations

### **ANAO Audit Report No.8 2012–13**

*Australian Government Coordination Arrangements for Indigenous Programs*

Department of Families, Housing, Community Services and Indigenous Affairs

**ANAO Audit Report No.9 2012–13**

*Delivery of Bereavement and Family Support Services through the Defence Community Organisation*

Department of Defence

Department of Veterans' Affairs

**ANAO Audit Report No.10 2012–13**

*Managing Aged Care Complaints*

Department of Health and Ageing

**ANAO Audit Report No.11 2012–13**

*Establishment, Implementation and Administration of the Quarantined Heritage Component of the Local Jobs Stream of the Jobs Fund*

Department of Sustainability, Environment, Water, Population and Communities

**ANAO Audit Report No.12 2012–13**

*Administration of Commonwealth Responsibilities under the National Partnership Agreement on Preventive Health*

Australian National Preventive Health Agency

Department of Health and Ageing

**ANAO Audit Report No.13 2012–13**

*The Provision of Policing Services to the Australian Capital Territory*

Australian Federal Police

**ANAO Audit Report No.14 2012–13**

*Delivery of Workplace Relations Services by the Office of the Fair Work Ombudsman*

Department of Education, Employment and Workplace Relations

Office of the Fair Work Ombudsman

**ANAO Audit Report No.15 2012–13**

*2011–12 Major Projects Report*

Defence Materiel Organisation

**ANAO Audit Report No.16 2012–13**

*Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2011*

Across Agencies

**ANAO Audit Report No.17 2012–13**

*Design and Implementation of the Energy Efficiency Information Grants Program*  
Department of Climate Change and Energy Efficiency

**ANAO Audit Report No.18 2012–13**

*Family Support Program: Communities for Children*  
Department of Families, Housing, Community Services and Indigenous Affairs

**ANAO Audit Report No.19 2012–13**

*Administration of New Income Management in the Northern Territory*  
Department of Human Services

**ANAO Audit Report No.20 2012–13**

*Administration of the Domestic Fishing Compliance Program*  
Australian Fisheries Management Authority

**ANAO Audit Report No.21 2012–13**

*Individual Management Services Provided to People in Immigration Detention*  
Department of Immigration and Citizenship

**ANAO Audit Report No.22 2012–13**

*Administration of the Tasmanian Forests Intergovernmental Contractors Voluntary Exit Grants Program*  
Department of Agriculture, Fisheries and Forestry

**ANAO Audit Report No.23 2012–13**

*The Australian Government Reconstruction Inspectorate's Conduct of Value for Money Reviews of Flood Reconstruction Projects in Victoria*  
Department of Regional Australia, Local Government, Arts and Sport

**ANAO Audit Report No.24 2012–13**

*The Preparation and Delivery of the Natural Disaster Recovery Work Plans for Queensland and Victoria*  
Department of Regional Australia, Local Government, Arts and Sport

**ANAO Audit Report No.25 2012–13**

*Defence's Implementation of Audit Recommendations*  
Department of Defence

**ANAO Audit Report No.26 2012–13**

*Remediation of the Lightweight Torpedo Replacement Project*

Department of Defence;

Defence Material Organisation

**ANAO Audit Report No.27 2012–13**

*Administration of the Research Block Grants Program*

Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education

**ANAO Report No.28 2012–13**

*The Australian Government Performance Measurement and Reporting Framework: Pilot Project to Audit Key Performance Indicators*

Across Agencies

**ANAO Audit Report No.29 2012–13**

*Administration of the Veterans' Children Education Schemes*

Department of Veterans' Affairs

**ANAO Audit Report No.30 2012–13**

*Management of Detained Goods*

Australian Customs and Border Protection Service

**ANAO Audit Report No.31 2012–13**

*Implementation of the National Partnership Agreement on Homelessness*

Department of Families, Housing, Community Services and Indigenous Affairs

**ANAO Audit Report No.32 2012–13**

*Grants for the Construction of the Adelaide Desalination Plant*

Department of Sustainability, Environment, Water, Population and Communities

Department of Finance and Deregulation

Department of the Prime Minister and Cabinet

**ANAO Audit Report No.33 2012–13**

*The Regulation of Tax Practitioners by the Tax Practitioners Board*

Tax Practitioners Board

Australian Taxation Office



**ANAO Audit Report No.34 2012–13**

*Preparation of the Tax Expenditures Statement*

Department of the Treasury

Australian Taxation Office

**ANAO Audit Report No.35 2012–13**

*Control of Credit Card Use*

Australian Trade Commission

Department of the Prime Minister and Cabinet

Geoscience Australia

**ANAO Audit Report No.36 2012–13**

*Commonwealth Environmental Water Activities*

Department of Sustainability, Environment, Water, Population and

Communities

**ANAO Audit Report No.37 2012–13**

*Administration of Grants from the Education Investment Fund*

Department of Industry, Innovation, Climate Change, Science, Research and

Tertiary Education

**ANAO Audit Report No.38 2012–13**

*Indigenous Early Childhood Development: Children and Family Centres*

Department of Education, Employment and Workplace Relations

**ANAO Audit Report No.39 2012–13**

*AusAID's Management of Infrastructure Aid to Indonesia*

Australian Agency for International Development (AusAID)

**ANAO Audit Report No. 40 2012–13**

*Recovery of Centrelink Payment Debts by External Collection Agencies*

Department of Human Services

**ANAO Audit Report No.41 2012–13**

*The Award of Grants Under the Supported Accommodation Innovation Fund*

Department of Families, Housing, Community Services and Indigenous Affairs

**ANAO Audit Report No.42 2012–13**

*Co-location of the Department of Human Services' Shopfronts*

Department of Human Services

**ANAO Audit Report No.43 2012–13**

*Establishment, Implementation and Administration of the General Component of the Local Jobs Stream of the Jobs Fund*

Department of Education, Employment and Workplace Relations

**ANAO Audit Report No. 44 2012–13**

*Management and Reporting of Goods and Services Tax and Fringe Benefits Tax Information*

Australian Taxation Office

**ANAO Audit Report No. 45 2012–13**

*Cross-Agency Coordination of Employment Programs*

Department of Education, Employment and Workplace Relations

Department of Human Services

**ANAO Audit Report No. 46 2012–13**

*Compensating F-111 Fuel Tank Workers*

Department of Veterans' Affairs

Department of Defence

**ANAO Audit Report No. 47 2012–13**

*AUSTRAC's Administration of its Financial Intelligence Function*

Australian Transaction Reports and Analysis Centre

**ANAO Audit Report No.48 2012–13**

*Management of the Targeted Community Care (Mental Health) Program*

Department of Families, Housing, Community Services and Indigenous Affairs

## Current Better Practice Guides

---

The following Better Practice Guides are available on the ANAO website.

Preparation of Financial Statements by Public Sector Entities	Jun 2013
Human Resource Information Systems – Risks and Controls	Jun 2013
Public Sector Internal Audit	Sept 2012
Public Sector Environmental Management	Apr 2012
Developing and Managing Contracts – Getting the right outcome, achieving value for money	Feb 2012
Public Sector Audit Committees	Aug 2011
Fraud Control in Australian Government Entities	Mar 2011
Strategic and Operational Management of Assets by Public Sector Entities – Delivering agreed outcomes through an efficient and optimal asset base	Sept 2010
Implementing Better Practice Grants Administration	Jun 2010
Planning and Approving Projects – an Executive Perspective	Jun 2010
Innovation in the Public Sector – Enabling Better Performance, Driving New Directions	Dec 2009
SAP ECC 6.0 – Security and Control	Jun 2009
Business Continuity Management – Building resilience in public sector entities	Jun 2009
Developing and Managing Internal Budgets	Jun 2008
Agency Management of Parliamentary Workflow	May 2008
Fairness and Transparency in Purchasing Decisions – Probity in Australian Government Procurement	Aug 2007
Administering Regulation	Mar 2007
Implementation of Program and Policy Initiatives – Making implementation matter	Oct 2006

