

# Audit Report No. 16 1996-97

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## Payment of Accounts

### Financial Control and Administration Audit

Tabled 25 November 1996

#### Summary and Recommendations

1. Payments for goods and services by agencies operating on the Commonwealth Public Account (CPA) are estimated to amount to \$8 billion annually.

#### Audit objectives

2. The main objectives of the audit were to assess the management and administration of the payment of accounts function in the Commonwealth and to identify, develop and report better practice to promote overall improvements in public administration.

#### Audit conclusion

3. The ANAO concluded that the payment of accounts function was being administered satisfactorily within the context of the current financial legislative and management framework. The ANAO considers, however, that better practices could be achieved through two main avenues, namely:

- changes in the management and organisational framework for the payment of accounts; and
- greater use of advanced information technology.

4. Areas of the management and organisational framework where improvement is warranted include:

- management reporting and performance measurement;
- the use of risk management processes; and
- increased flexibility in agencies' terms of payment.

5. The ANAO considers that agencies should be assessing the cost effectiveness of the earliest possible adoption of electronic commerce capabilities. However, until the electronic commerce service is fully developed, agencies should take advantage of current technologies available for payment of accounts on their current or proposed financial management information systems. Specific technologies and processes that could be utilised more fully include:

- automated matching of payments with purchase orders and receipt of goods and services information;

- automated sorting, aggregation and batching of claims;
- the making of payments by direct credit instead of by cheque; and
- automated management information and performance reports.

6. The ANAO has made a number of recommendations at agency level and in relation to the Department of Finance as the responsible central agency. It is envisaged that the implementation of the ANAO recommendations would lead to better practices in the payment of Commonwealth accounts and would provide improved compliance with the administrative requirements.

### **Summary of findings**

7. The major findings of the audit were as follows:

- Most agencies could not identify the total costs of the payment of accounts function. However, ANAO estimates, based on data provided by agencies, indicate that Commonwealth costs are higher than in the private sector (*refer paragraphs 1.5 and 1.6*).
- Certain accounting controls, organisational and processing arrangements, and management reporting and performance measurement mechanisms required improvement to enable agencies to exercise better management of the payment of accounts function (*refer paragraphs 1.8 to 1.14*).
- Agencies were making limited use of risk management in the verification of payments and there was little apparent recognition of the need for functional risk assessments at the agency level (*refer paragraphs 1.15 to 1.21*).
- The payment by due date policy introduced in 1987 has, by and large, achieved its objective of ensuring that accounts are paid on time. However, a focus on strict compliance with the policy has led to some inflexibilities in the process (*refer paragraphs 1.22 to 1.29*).
- Despite direct credits being the Commonwealth's preferred mode of payment, a large number of payments were still being made by cheque. This is largely because of the limited payment advice information that can accompany direct credits (*refer paragraphs 1.30 to 1.42*).
- A high proportion of payments between agencies operating on the CPA are made by cheque on the same payment terms as payments to external suppliers. Cost savings from reduced cheque production and handling, and from reduced follow-up action by receiving agencies could be achieved (*refer paragraphs 1.43 to 1.46*).
- Several accounts payable systems operated by agencies would benefit from increased automation (*refer paragraphs 1.47 to 1.50*).

### **Recommendations**

8. The ANAO's recommendations with report paragraph references are set out below.

#### **Performance measurement**

The ANAO *recommends* that agencies:

Recommendation  
No. 1  
Para. 1.14

- establish credible performance indicators for measuring the effectiveness and efficiency of the accounts processing function; and
- develop regular reporting mechanisms for monitoring actual performance against the indicators and clear procedures for actioning of the related reports by executive management.

### **Risk management**

Recommendation  
No. 2  
Para. 1.19

The ANAO *recommends* that agencies review the verification procedures applied to payments within the prescribed classes as defined by the Finance Regulations with a view to limiting verification procedures.

### **Cash management / terms of payment**

Recommendation  
No. 3  
Para. 1.28

The ANAO *recommends* that the Department of Finance encourage greater flexibility within agencies to vary the terms of payment, where there is an overall advantage to do so, and after having considered cash management and other possible impacts on administrative performance.

### **Modes of payment**

Recommendation  
No. 4  
Para. 1.33

The ANAO *recommends* that, in conjunction with its formal market testing of cheque printing and distribution in 1997, the Department of Finance should assess the impact of charging for cheques and consider the costs/benefits of imposing different charges for normal cheques and collect cheques.

Recommendation  
No. 5  
Para. 1.40

The ANAO *recommends* that the Department of Finance liaise more closely with agencies to identify and resolve problems in using direct credit as a mode of payment and to encourage the utilisation of direct credit as the preferred mode for all types of payments.

Recommendation  
No. 6  
Para. 1.42

The ANAO *recommends* that agencies consider undertaking a cost/benefit analysis of modifying their systems to enable direct credit to be the primary mode of payment for goods and services, travelling allowance and other non-salary allowances in the light of the number and cost of such transactions.

### **Inter-agency payments**

Recommendation  
No. 7  
Para. 1.46

The ANAO *recommends* that, where practicable, all inter-agency payments be made by way of direct credit, immediately following any verification processes.

### **System capabilities**

The ANAO *recommends* that, where practicable and cost-effective, agencies:

Recommendation  
No. 8  
Para.1.50

- enhance or replace their accounts payable systems to provide increased automated facilities for the sorting, batching, reporting and reconciling of payments; and
- ensure that users are suitably trained in the operation of system capabilities.

### **Current and future developments**

8. The implementation of electronic commerce and the development of buyer/supplier relationships are seen as contemporary initiatives which will impact favourably on the payment of accounts functions of all agencies in the foreseeable future. It can also be expected that several Commonwealth initiatives, including new financial management and accountability legislation and the adoption of new financial management information systems, will have wide-ranging ramifications for the payments function in the Commonwealth public sector. The ANAO suggests that agencies should be assessing the benefits and costs of the opportunities offered by these developments or be planning to do so in the near future.

9. Whereas other governments have provided management incentives by devolving complete responsibility for processing payments to their agencies, Commonwealth agencies operating on the CPA are required to process their payments through the Department of Finance. The ANAO suggests that the Department of Finance undertake a cost/benefit study comparing the current centralised payment processing system and alternative methods, including individual agency processing particularly in the light of the changes mentioned in paragraph 8.

### **Better practice**

10. The audit identified examples of better practice currently used by the agencies reviewed. Where these practices had general application, they were consolidated with applicable private sector better practices to create the companion [better practice guide for the payment of accounts](#) in the Commonwealth public sector.

## **1. Detailed Audit Findings**

### **Context**

1.1 Payments for goods and services by agencies operating on the Commonwealth Public Account (CPA) are estimated to amount to approximately \$8 billion annually and involve transactions with some 30 000 suppliers.

1.2 The payment of accounts function in the Commonwealth has not been subject to a major public review since the Block scrutiny of 1987. <sup>1</sup>

1.3 Current initiatives impacting on the Commonwealth's payment of accounts processes and systems include:

- the impending introduction of the proposed financial management and accountability legislation;
- the selection of a suite of suitable financial management information systems by the Office of Government Information Technology (OGIT); and
- the development of electronic purchasing and payment by the Departments of Administrative Services and Finance.

1.4 The main objectives of the audit were to assess the management and administration of the payment of accounts function and to identify, develop and report better practice. Particular attention was paid to:

- the extent of management control exercised by agencies;
- the performance of the processing systems operated by individual agencies and the Department of Finance; and
- better practices in both the public and private sectors.

Additional background information and details of the audit objectives, scope and approach, are provided at Appendixes 1 and 2 respectively.

## Costs

1.5 Most of the agencies reviewed could not identify with any certainty the actual number of full-time staff equivalents working on the payment of accounts function or the total costs of the function. On the basis of information available, the ANAO estimated that the direct labour costs varied considerably across agencies and were significantly higher than those reported by private sector entities. <sup>2</sup> Chart 1 illustrates the gap.



1.6 While recognising that there may be some valid reasons for variations in the above costs of paying accounts, it is clear that some cost reductions could be achieved in Commonwealth agencies through the adoption of better practices. Implementation of the recommendations of this report and individual agency benchmarking against the better

practice guide, *Paying Accounts*, produced in conjunction with this report, should assist agencies in identifying the areas of potential cost savings and in implementing better practices over time.

1.7 The main issues and recommendations are set out below.

### **Management control and performance measurement**

1.8 Management's objectives for the payment of accounts are to ensure that all valid claims from suppliers are paid in an appropriate time frame and to maximise the efficiency of payment processing. Management meets these objectives by establishing accounting controls, organisational and processing arrangements, and performance and reporting mechanisms.

#### **Accounting controls**

1.9 Overall, the agencies reviewed maintained satisfactory accounting controls over their payment of accounts activities. Areas where the audit identified that improvements were warranted included:

- *approval of purchases* - in many instances, where purchase orders had not been completed prior to purchase, expenditure was approved subsequent to the receipt of the invoice. Proposals to spend public moneys should be approved prior to entering into commitments with suppliers; and
- *control over credit notes* - the recording and reporting of credit notes in several agencies were haphazard.

#### **Organisational and processing framework**

1.10 Where the accounts processing task had been decentralised in an effort to make the function more responsive to program needs, some agencies had experienced difficulties in maintaining control over, and securing efficiencies in, the payment processes. In recent times there had been a general trend towards recentralisation in these agencies. Furthermore, one agency, the Department of Social Security, was trialling a centralised payment of accounts section in lieu of multiple operations which previously operated in the same city.

1.11 The ANAO also identified that:

- there was a general absence of periodic review or monitoring of organisational and processing arrangements; and
- although some agencies had undertaken benchmarking reviews which had recommended changes to their payment of accounts function, only minimal changes had been made.

#### **Performance and reporting mechanisms**

1.12 The ANAO concluded that current management performance and reporting mechanisms required improvement to enable management to exercise suitable ongoing control over the accounts processing function. Findings included:

- a general absence of established performance targets for the payment of accounts function. Where targets had been set, they were generally limited to performance against the due date policy and were seldom met or followed-up; and
- management reports were mainly concerned with due date processing and quality assurance reviews and were seldom passed to executive levels.

1.13 The development of performance targets, such as payment performance against due date, average cost per payment, numbers of invoices processed and supplier contacts/queries would provide suitable signposts allowing managers to identify, and react to, problem areas.

### **Recommendation No.1**

1.14 The ANAO *recommends* that agencies:

- establish credible performance indicators for measuring the effectiveness and efficiency of the accounts processing function; and
- develop regular reporting mechanisms for monitoring actual performance against the indicators and clear procedures for actioning of the related reports by executive management.

### **Verification processes and risk management**

1.15 The risk management guidelines developed by the Block scrutiny in relation to the verification of payments have generally not been adapted to suit the functional and operating environment of individual agencies.

1.16 The Block scrutiny recognised that prime responsibility for accounts processing rested with individual agencies. Its recommendations hinged on the application of a risk-based management approach to accounts processing - 'the emphasis should be on the cost/benefit of checking each type of account consistent with adequate risk assessment and commensurate internal controls'<sup>3</sup>.

### **Prescribed classes of payment**

1.17 The Finance Regulations recognise that the verification and validation processes applied to each payment should reflect the risk associated with the payment. Accordingly, reduced verification checks are allowed for prescribed classes of payment. As the majority of payments fall within these prescribed classes, most payments can be verified utilising these reduced procedures.

1.18 In the agencies reviewed, the ANAO identified that it was common practice for full verification processes to be applied to payments within the prescribed classes for which reduced checking could be utilised.

### **Recommendation No.2**

1.19 The ANAO *recommends* that agencies review the verification procedures applied to payments within the prescribed classes as defined by the Finance Regulations with a view to limiting verification procedures.

## **Risk assessment**

1.20 There has been no apparent recognition that the broad risk assessment undertaken by the Block scrutiny needed to be developed on an individual organisation basis to reflect the risks/benefits specific to each agency. Formal assessments of risk and associated internal controls were seldom completed in the agencies reviewed.

1.21 Appendix 3 provides an example of a risk assessment framework for the payment of accounts function which could be adapted to agencies' specific requirements.

## **Terms of payment and due date processing**

1.22 The audit identified little evidence of customer dissatisfaction with the payment performance of the agencies reviewed. However, there was a need to improve the accuracy of payment performance statistics and to enable and encourage more flexible terms of payment.

### **Standard terms of 30 days**

1.23 The Commonwealth's terms of payment policy (i.e. payment 30 days from receipt of goods and services and a correctly rendered invoice) was implemented following recommendations arising from the 1987 Block scrutiny on accounts processing. The scrutiny found that most accounts were processed in order of receipt, with about 60% paid in 30 days or less and about 40% in more than 30 days. The scrutiny estimated that the Commonwealth bore an additional \$11 million a year in public debt interest by making payments before they were due, while supplier dissatisfaction with slow payments was evidenced in increased prices to cover the associated costs.

1.24 The ANAO found that, according to agencies' statistics, most of the agencies in the current review paid approximately 90% of claims on or before the due date and approximately 10% after the due date. The accuracy of the statistics, however, was affected by a number of matters, such as the non-recording of the date of receipt of claims or of goods and services in many instances, and the use of non-standard due dates. Furthermore, the statistics did not provide an indication of payments made earlier than 30 days. Nevertheless, the statistics show a marked reduction in the proportion of late payments during the period 1987 to 1996.

### **Non-standard terms**

1.25 The determination of the due date was not always in accord with the Commonwealth's standard terms of payment. This is permitted in circumstances where a cash management advantage can be obtained.

1.26 In the agencies reviewed, the justifications for earlier due dates did not always address the cash management considerations. Agencies, on occasions, advanced the due date to take advantage of factors which could not always be quantified, such as anticipated increases in the level of service provided by suppliers. The ANAO considered a number of these circumstances to be advantageous to the Commonwealth. On other occasions, however, the date was advanced for no apparent reason. The ANAO noted that, in general, the practice of advancing payment was more common in the month of June than at other times.



1.27 The due date policy has also introduced a degree of rigidity, perhaps perceived rather than real, which has contributed to unintended consequences, including:

- *lack of flexibility.* The minimal number of cases identified in the audit where payment discounts, for either early payments or payments in advance, had been negotiated with suppliers could well reflect a perception by agencies of inflexibility in the current policy. The perceived lack of flexibility could also prove counter-productive to the development of improved working arrangements between agencies and their suppliers; and
- *rationalisation of numbers of payments.* The possibility of rationalising the number of payments made has been hindered by the application of the due date policy. For example, the practice of combining payments to regular suppliers into single monthly payments had not been adopted in the agencies reviewed.

### **Recommendation No.3**

1.28 The ANAO *recommends* that the Department of Finance encourage greater flexibility within agencies to vary the terms of payment, where there is an overall advantage to do so, and after having considered cash management and other possible impacts on administrative performance.

1.29 The Department of Finance advised that it agreed agencies should vary the standard terms of payment where they have been able to establish that there would be a clear advantage to the Commonwealth after considering cash and risk management implications.

### **Modes of payment**

1.30 Payment may be effected by several modes, including cheque, direct credit, cash, credit card, and Financial Electronic Data Interchange (FEDI). At this time, FEDI is not generally used for payments for goods and services. The Australian Government Credit Card (AGCC) represents a significant mode of payment, particularly for small values, and is used in conjunction with the cheque and/or direct credit modes to offer processing and cash management savings.

### **Cheques**

1.31 Cheques may be issued for delivery by mail ('normal') or for collection ('collect'). The Department of Finance provides these services for a charge of 85 cents per cheque.

1.32 Charging for cheques was introduced from 1995-96 to encourage agencies to use direct credit (the Department of Finance's preferred mode of payment) and to assist in the funding for the development of FEDI. The amount of the charge was calculated as the estimated differential cost between paying by normal cheque and paying by direct credit, and was to be reviewed annually. The Department of Finance advised that cheque charges will be reviewed following the completion of a formal market testing of cheque printing and distribution in early 1997. Despite the introduction of the charge, the use of direct credit did not increase significantly and cheque production remained at similar levels to previous years.

### **Recommendation No.4**

1.33 The ANAO *recommends* that, in conjunction with its formal market testing of cheque printing and distribution in 1997, the Department of Finance should assess the impact of charging for cheques and consider the costs/benefits of imposing different charges for normal cheques and collect cheques.

### **Direct credits**

1.34 Direct credits to a payee's account at a financial institution are considered by the Department of Finance to be the most efficient mode of payment currently available.

1.35 The Department of Finance makes approximately 27 million direct credit payments annually, although the great majority of these are for salaries, allowances and benefit type payments. The ANAO noted, however, that some agencies were making very few travelling allowance payments by direct credit. On the other hand, the Department of Defence had successfully trialled, and subsequently adopted, direct credit as the normal mode of payment of non-salary allowances.

1.36 Direct credits for the payment of goods and services have continued to increase over recent years but still represent only a small portion of the total number of payments for goods and services. The main reasons for this are that:

- suppliers have difficulty in identifying direct credits; and
- some agencies' accounting systems are not capable of processing direct credits.

1.37 Difficulties in identification have arisen from two main sources, namely:

- the payment details field in the direct credit system operated by the financial institutions is limited (18 characters) compared to the information that can be provided on a cheque payment advice (25 lines by 70 characters). As a result agencies often need to send separate advice (by mail, fax and phone) to assist in the identification of payments; and
- the 'name of the remitter' field provided to financial institutions by the Department of Finance often included numeric characters rather than alpha characters describing the name of the remitter. The Department of Finance has scheduled a change to its system to correct this problem from November 1996.

1.38 The ANAO considers that the resolution of the above matters would create a further incentive for agencies to adopt, and suppliers to accept, direct credit as a cost-effective mode of payment/receipt. Accordingly, the ANAO suggested to the Department of Finance that, as the central coordinating agency and the direct link with the financial institutions, it coordinate, investigate and resolve the difficulties that agencies and suppliers are experiencing with payments by direct credits as early as possible.

1.39 In response to the ANAO representations on this matter, the Department of Finance advised that it actively promotes the use of direct credit as best payment practice where it is appropriate and liaises with the Reserve Bank of Australia on a day-to-day basis to ensure that operational problems are resolved expeditiously. The Department also advised that the Reserve Bank makes representations to the banking industry on behalf of the Department. However, many problems are largely outside the control of the Bank or the Department.

### **Recommendation No.5**

1.40 The ANAO *recommends* that the Department of Finance liaise more closely with agencies to identify and resolve problems in using direct credit as a mode of payment and to encourage the utilisation of direct credit as the preferred mode for all types of payments.

1.41 The Department of Finance agreed to increase its liaison with agencies where resources permit.

### **Recommendation No.6**

1.42 The ANAO *recommends* that agencies consider undertaking a cost/benefit analysis of modifying their systems to enable direct credit to be the primary mode of payment for goods and services, travelling allowance and other non-salary allowances in the light of the number and cost of such transactions.

### **Inter-agency payments**

1.43 Inter-agency payments are estimated at between 12-25% of the Commonwealth's total number of payments for goods and services.

1.44 The ANAO found that, as for other payments, a high proportion of inter-agency payments were made by cheque. Furthermore, inter-agency payments generally were found to be subject to the same payment terms as those to external suppliers, i.e. payment 30 days after receipt of invoice and goods and services. At least one agency, however, normally paid such claims within fourteen days.

1.45 The ANAO considers that, in the case of transactions within the CPA, where there is no interest benefit to the Commonwealth from either early or late payment, payment should be made by direct credit as soon as practicable. The Department of Finance, while recognising the practical difficulties for agencies in differentiating interagency payments for preferential processing, has supported the recommendation below which would result in cost savings from reduced cheque production and handling, and from reduced follow-up action by receiving agencies.

### **Recommendation No.7**

1.46 The ANAO *recommends* that, where practicable, all inter-agency payments be made by way of direct credit, immediately following any verification processes.

### **System capabilities/automated functions**

1.47 As part of the financial reforms of recent years, agencies have been required to implement their own financial management information systems, including accounts payable systems.

1.48 The ANAO found a number of areas where the accounts payable systems, as operated by the agencies reviewed, could be improved. For example,

- many of the systems were not well geared for the reporting of necessary management information;
- a number of systems did not have a facility installed for the automatic sorting and

batching of payments;

- some agencies were not making full use of 'electronic signatures' and in some cases certifying officers signed the claim form as well as certifying the payment electronically;
- some agencies' system interfaces with FIRM needed upgrading; and
- automated reporting and reconciliation processes required enhancement in most cases.

1.49 In addition, many system users did not have a strong understanding of their system's capabilities and were thus likely to underutilise their involvement.

### **Recommendation No.8**

1.50 The ANAO *recommends* that, where practicable and cost-effective, agencies:

- enhance or replace their accounts payable systems to provide increased automated facilities for the sorting, batching, reporting and reconciling of payments; and
- ensure that users are suitably trained in the operation of system capabilities.

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## **2. Current and Future Developments**

2.1 There are several current and future developments that will impact on the payment of accounts functions of all organisations over the next few years. This chapter deals with those developments and discusses some of the issues that need to be addressed by Commonwealth agencies in moving towards their implementation.

### **Buyer/supplier relationships**

2.2 Presently many businesses are entering into buyer/supplier relationships and dealing with a lesser number of suppliers for their procurement activities. One advantage of this trend is that there is a fair degree of certainty for both the buyer and the supplier, in that each is contributing to the operations of the other's business. While the main buyer benefits of these types of relationships are usually better service, continuity of supply and lower prices, there may also be some benefits impacting on the payment of accounts function.

2.3 The ANAO found that although most agencies had regular suppliers for the provision of their major and most frequent requirements, there was little evidence that agencies had cultivated strategic or special buyer/supplier relationships. A common exception, however, related to the purchase of air fares, where most agencies had contracts with the airline companies for the provision of all their air travel requirements. These contracts usually provided certain discounts and other services, and were often paid in advance.

2.4 The main advantages of buyer/supplier relationships, from the payment of accounts perspective, relate to the agreed terms, method and frequency of payment. For example, terms of payment may take the form of prepayment as in the travel contracts, or immediate payment on receipt of goods. Buyer/supplier relationships may also open up avenues for reduced checking of accounts.

2.5 The ANAO suggests that agencies should actively seek any opportunities they may have for improving payment practices through existing or potential relationships with suppliers.

### **Commonwealth initiatives**

2.6 There are several Commonwealth initiatives currently in progress that will impact on the payment of accounts function. These initiatives and the respective sponsoring agencies are:

- new financial management and accountability legislation - Department of Finance;
- new financial management information systems - Office of Government Information Technology; and
- development of an electronic commerce purchasing and payment system - Electronic Commerce Office of the Department of Administrative Services, and the Department of Finance.

### **New financial management and accountability legislation - Department of Finance**

2.7 The new financial management and accountability legislation may come into operation from 1 July 1997. The main impact of the proposed legislation is that responsibility for financial management and accountability will be placed on the Chief Executive Officer of each agency, i.e. the legislative requirements for payments processes will be less prescriptive. Among other things, it will provide opportunities for more buyer/supplier relationships and greater flexibility in the payment of accounts process.

### **New financial management information systems - Office of Government Information Technology**

2.8 During August 1996 the Office of Government Information Technology (OGIT) announced a suite of shared systems comprising six financial management information systems and four human resource management systems that Commonwealth agencies wishing to replace either of their current systems would be required to choose from.

2.9 The main purpose of the suite of systems is that, over time, there will be considerably fewer systems operated by Commonwealth agencies. The advantages flowing from this are savings in resources relating to purchasing, development, training, compatibility, maintenance, mobility and customer service.

2.10 The new systems will also bring advances in technology, including electronic commerce capabilities. As a result, a number of the system issues currently restricting the performance of some agencies' accounts payable systems should be overcome as agencies move to a new system in the suite.

### **Development of electronic commerce**

2.11 Electronic commerce is defined as '... the use of computer and telecommunications technologies, particularly on an inter-enterprise basis, to support trading in goods and services. Electronic commerce uses a variety of technologies, such as electronic data interchange, electronic mail, facsimile transfer, continuous acquisition and life cycle

support and electronic catalogue and directory systems'.<sup>4</sup>

2.12 On 20 August 1996 the Minister for Administrative Services released a statement which affirmed the Commonwealth Government's commitment to expanding its electronic commerce capabilities.<sup>5</sup>

#### *Purchasing system - Electronic Commerce Office*

2.13 A Commonwealth Electronic Commerce Service is being established within the Department of Administrative Services to service Commonwealth departments and agencies for electronic commerce purchasing. The Government expects agencies to use the service where it is cost-effective to do so. Furthermore, with effect from 1 July 1997, agencies will be required, through the Commonwealth Electronic Commerce Service, to:

- ensure all publicly available opportunities to do business with the Commonwealth are accessible electronically to all potential suppliers; and
- report on purchases, and supply purchasing-related information.

2.14 Agencies will also be strongly encouraged to plan for the implementation of electronic commerce, to adopt electronic data interchange as the preferred method for purchasing and payment, to review planning for electronic commerce annually, and to report progress on its implementation to the Department of Administrative Services.

#### *Financial Electronic Data Interchange - Department of Finance*

2.15 The Department of Finance has conducted pilot Financial Electronic Data Interchange (FEDI) payment facilities in two agencies and is responsible for further development.<sup>6</sup> While the pilots used FEDI technology successfully, the cost of general implementation has yet to be determined. Present indications are that the transaction cost will be higher than the cost of a cheque, resulting in FEDI being most suitable for high-value, low-volume transactions.

2.16 To take advantage of FEDI, agencies will need to have appropriate capabilities installed on their financial management information systems. For some agencies, this will require system enhancement or the purchase of a new system.

### **The role of the Department of Finance in processing payments**

2.17 At this time all agencies operating on the CPA are required to process most of their goods and services payments through the Department of Finance. The main advantage of centralised processing is the generation of economies of scale with only one system and one bank account.

2.18 The central processing of payments is historically a by-product of the central ledger system for recording Commonwealth expenditure. Since the implementation of separate financial management information systems in agencies, many agencies now have systems with the capability to distribute payments directly to payees.

2.19 Other governments in Australia and overseas have given agencies the complete responsibility for processing payments. Furthermore, the Commonwealth has given

responsibility to the Departments of Social Security and Veterans' Affairs and the Australian Taxation Office to make millions of special purpose payments from their own drawing accounts. However, other agencies that are responsible for paying benefits, e.g. the Department of Employment, Education, Training and Youth Affairs, are required to process their payments through the drawing account operated by the Department of Finance.

2.20 The main advantage of enabling agencies to effect their own payments is that each individual agency has full responsibility for its payments and therefore is fully accountable for its costs and performance. Some of the benefits to be gained include:

- there is increased incentive for the agency to become more efficient as full costs must be borne;
- cash management performance can be measured; and
- complete details of payments are recorded on the agency's own accounting system, facilitating inquiries on the status of payments and the reconciliation of the bank account.

Furthermore, it is conceivable that the provision of full responsibility for payment processing may provide agencies with the incentive to pay by direct credit rather than cheque. However, there is also considerable advantage for overall cash management in being able to achieve a daily balance across all budget entities.

2.21 The ANAO suggests that the Department of Finance undertake a cost/benefit study comparing the current centralised payment processing system and alternative systems, including individual agency payment processing. Such a study should include analysis of the arrangements operating in other government sectors, the drawing account operations of other agencies, and future technologies such as electronic commerce.

2.22 The Department of Finance advised that it is committed to market testing its central accounting systems, including FIRM, by June 1998. This project will examine options, including devolving functions to agencies, for delivery of the services.

### **Future payment of accounts systems in the Commonwealth**

2.23 The changing business environment and Commonwealth initiatives outlined above indicate that major changes are on the horizon for the way in which Commonwealth departments and agencies conduct their purchasing and payments functions.

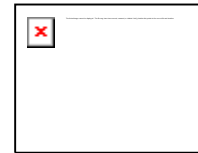
2.24 Electronic commerce purchasing and payments seems to be the way of the foreseeable future for all but maybe the very small agencies. In many instances, however, the conversion to electronic commerce and new financial management information systems is likely to be a number of years away.

2.25 Better practices for the payment of accounts function that could be adopted by Commonwealth agencies prior to conversion to electronic commerce are as follows:

- the formation of *strategic alliances*;

- *centralisation* of the payment function;
- full *system integration*, including electronic notification of receipt and automatic three-way matching of invoice, purchase order and notification of receipt; and
- *evaluated receipt settlement*, i.e. payment on the receipt of goods and the elimination of invoices.

2.26 Each of these practices is explored in the better practice guide, *Paying Accounts*.



Canberra ACT  
25 November 1996

P. J. Barrett  
Auditor-General

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The Block scrutiny was undertaken by the Department of Finance with the results reported in *Efficiency Scrutiny on Processing of Accounts - A Report for the Minister for Finance*, Department of Finance, 1987. The recommendations of the scrutiny followed two broad themes: namely, to ensure payment of accounts by the due date and to maximise the efficiency of accounts processing through the introduction of revised procedures. The ANAO reviewed the implementation of the efficiency scrutiny recommendations during 1988-89.

2

Sourced from 1993 international benchmarking studies conducted by Price Waterhouse.

3

*Efficiency Scrutiny on Processing of Accounts - a Report for the Minister for Finance*, Department of Finance, Canberra, 1987, paragraph 40.

4

Statement of Direction on Electronic Commerce, April 1995.

5

Statement of Direction on Electronic Commerce, August 1996.



FEDI provides a fast (approximately 1-2 hour turnaround) and secure facility for effecting direct credit payments and providing associated electronic remittance information to payees. Individual confirmation that a particular payment has been credited to the payee's account is also provided.

## **Appendix 1 - Background**

### **FCA audits**

1. Financial Control and Administration (FCA) audits are aimed at improving the quality of public sector administration by assisting and encouraging agencies to achieve better practices. FCA audits are undertaken across a selection of agencies and involve the identification of better practices from both within and outside the public sector. The main output at the end of the audit is the publication of a better practice guide. The approach provides a benchmark against which each agency, service-wide, will be able to compare its respective performance and to implement improvements, where necessary.

### **Definition of payment of accounts**

2. Payment of accounts was defined for the purposes of the audit as *payments for goods and services*. It therefore did not include grants or benefit payments (e.g. pensions), nor salaries and allowances in the nature of salary.

### **Quantitative data**

3. The Commonwealth's payments for goods and services are estimated to amount to approximately \$8 billion annually. The number of suppliers to the Commonwealth is in the vicinity of 30 000. This data is based on purchasing data published in the Commonwealth Gazette (Purchasing and Disposals). <sup>1</sup>

### **The Commonwealth's financial and legislative framework**

4. Government departments, other branches of the public service and certain other government agencies operate on the Commonwealth Public Account (CPA) which is under the control of the Minister for Finance. These organisations are currently governed by the requirements of the Audit Act and make all of their payments for goods and services through the Department of Finance drawing accounts which are reimbursed daily through the CPA. All other government agencies (i.e. mostly statutory authorities) are usually governed by enabling legislation and make payments through their own bank accounts.

5. From July 1997 all organisations are expected to be governed by the new financial management and accountability legislation.

### **Previous reviews and audits**

#### **Block Efficiency Scrutiny**

6. In 1987 an Efficiency Scrutiny on the Payment of Accounts was undertaken by Mr David Block. The recommendations of the scrutiny, which were implemented progressively from July 1987, followed two broad themes, namely, to ensure payment of accounts by the due date, and to maximise the efficiency of accounts processing through the introduction of revised procedures, including reduced checking for certain classes of accounts.

7. The ANAO undertook a review of the implementation of the efficiency scrutiny during 1988 (Auditor-General's Report of April 1989 refers). The ANAO concluded that the recommendations of the scrutiny had been implemented effectively and that considerable savings had been achieved. There were some concerns, however, about the implementation of risk assessment and monitoring, the reporting of the savings achieved, and the adequacy of follow-up of post-implementation issues.

### **Cash management audits**

8. The ANAO undertook an efficiency audit of cash management in Commonwealth Government Departments from late 1993 (refer Auditor-General's Reports, No.22 of 1993-94 and No.10 of 1994-95). The second of these reports included recommendations relating to payment of accounts - the recommendations concerned due date processing, prepayments and intra-Commonwealth payments.

### **Credit card audits**

9. The Australian Government Credit Card was introduced into the Commonwealth as part of the financial reforms of the late 1980s. The ANAO undertook an efficiency audit of the Australian Government Credit Card in 1993-94 (refer Auditor-General's Reports, Nos.21 and 41 of 1993-94).

### **Financial statement audits**

10. The ANAO undertakes annual financial statement audits of Commonwealth departments and agencies. The reports on these audits provide an opinion on reported financial information, including expenses and creditors.

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## **Appendix 2 - Objectives, Scope, and Approach**

### **Objectives**

1. The main objectives of the audit *within each agency* were to identify good practices in the payment of accounts function, to assess the management and administration of the function and to recommend improvements as necessary.

2. The main objectives of the audit *across the Commonwealth* were to assess the management and administration of the payment of accounts function and to develop and publish a better practice guide. These objectives required analysis of information at each of the agencies selected for audit, as well as at the Department of Finance and other central agencies, and in the private sector.

### **Scope and focus**

3. The scope of the audit was restricted to the function of paying accounts for goods and services; it did not extend to the purchasing function. It involved an examination of the controls and processes in place for the payment of accounts, an assessment as to whether the identified controls and processes

were applied in accordance with legislative requirements and good management practice, and the identification of better practices operating outside the public sector.

4. The main focus of the audit was on the identification of better practices and included an emphasis on:

- organisational arrangements;
- risk management policies and practices relating to verification and certification functions;
- the use of information technology; and
- cash management policies and practices.

5. The audit concentrated on the payment of accounts function within agencies operating on the CPA and on the central agency role of the Department of Finance. It did not extend to the purchasing function, including the use of credit cards, except where particular purchasing controls were essential to the payment function.

### **Approach**

6. The audit approach comprised the following main elements:

- extensive research of relevant benchmarking and other reference information;
- conduct of field work at ten agencies, including regional offices;
- liaison with the Department of Finance and review and analysis of relevant data and processes;
- an emphasis on information gathering on the instructions, processes, organisations, costs and technologies applying to accounts processing;
- analysis of the information with a view to reporting better practices and developing relevant performance indicators; and
- the provision of advice as to the 'health' of accounts processing in the Commonwealth.

7. The audit was undertaken at each agency using two frameworks, namely, the management framework and the processing framework. The management framework covered aspects of organisation; policy, instructions and procedures; accounting system; and management reporting and review. The processing framework covered receipt of invoices; verification procedures, authorisation of payment; and reconciliation processes.

8. The audit at central agencies concentrated on the role of the Department of Finance, both as a policy maker and in an operational mode. This covered the provision of advice and proposals for legislative change and EDI, together with the cheque issuing and banking operations. In addition, relevant developments were examined at the Office of Government Information Technology, and the Electronic Commerce Office of the Department of Administrative Services.

9. Better practices in the private sector were researched mainly through the assistance of the chartered accounting firm, Price Waterhouse.

10. The cost of the audit was approximately \$430,000.

### Appendix 3 - Example Payment of Accounts Risk Assessment Framework

RISKS	POSSIBLE CAUSES	STRATEGIES TO ADDRESS IDENTIFIED RISKS	RESOURCE SAVINGS/COSTS IDENTIFIED
<b>1.1 Claims for payment are not date stamped or recorded on receipt, resulting in: record of claims against actioned; paid on due date.</b>	Claims directed to officers not responsible for recording claims; deficiencies; s; staff training;	Directions on purchase orders to clearly specify all claims to be sent to relevant area, e.g. accounting operations;	Minimal cost.
		mail room to time-stamp all mail on receipt;	Current requirement.
		claims to be registered on system by central receiving area, e.g. accounting operations;	Transfer of function from area of responsibility (if applicable).
		structured and comprehensive staff training.	Current requirement.

RISKS	POSSIBLE CAUSES	STRATEGIES TO ADDRESS IDENTIFIED RISKS	RESOURCE SAVINGS/COSTS IDENTIFIED
<b>1.2 Received claims inaccurate/incorrect/invalid/fraudulent.</b>	Inadequate segregation of duties; security over ctions; ntrls over vments; ols over input data ta incomplete, d/or unauthorised) ments; s incorrect/ certified by icers; d or generated by inaccurate; ntrls over cheque igning and s not received nditions of contracts ; nauthorised	Adequate segregation of duties between receiving, accounts payable and stores functions	Current requirement.
		IT general and application controls in place, e.g.: s rls checks (e.g. approved supplier n matched to purchase order/ orts, system check of invoice st previous claims); ntrls ntrls;	Current requirement.
		Processing controls ls independently reviewed and y ulations independently reviewed ed edits of critical data (e.g. er extensions, totals, ss tests) with queries investigated sting fully tested and updated to bles controlled and reviewed;	Current requirement.

	<p>dit notes; ates; of any volume with outside normal aff training.</p>	<p>invoices streamed according to risk: egic partners r govt agencies ns under \$1,000 r; <i>in conjunction with</i> checking of claims undertaken for 'other' stream only, with statistical sample drawn for other categories; <i>and</i> management review against key performance indicators; structured and comprehensive staff training.</p>	<p>Additional minimal resource requirements required to set up and document streaming, quality assurance and reporting procedures.  Significant ongoing resource savings to be achieved based on detailed certification procedures being applied to estimated 5-10% of transactions in 'other' stream. All other payments to be made on abbreviated checking allowed under Finance Reg 45A(3)(b)(ii).  Risk managed through use of detailed checking of sampled transactions with situation to be reviewed by management on ongoing basis in view of results obtained from quality assurance review and performance against key indicators.</p>
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<b>RISKS</b>	<b>POSSIBLE CAUSES</b>	<b>STRATEGIES TO ADDRESS IDENTIFIED RISKS</b>	<b>RESOURCE SAVINGS/COSTS IDENTIFIED</b>
<b>1.3 Payments made without authority.</b>	<p>Payments not certified by delegated officers; funds unavailable; inadequate staff training.</p>	<p>Delegations; system access controls; systems check of funds availability; structured and comprehensive staff training.</p>	<p>Current requirement.</p>
<b>1.4 Payment not recorded /incorrectly recorded in accounting records.</b>	<p>Posting errors; accounts not reconciled; sub-ledgers and financial ledger not reconciled; computer processing or posting errors;</p>	<p>IT general and application controls in place, e.g.: Input Controls -- access controls File Controls -- file access controls -- change controls Processing controls -- control totals independently reviewed and balanced daily;</p>	<p>Current requirement.</p>

	<p>advancing payments to show better program performance and spend budget allocation; inadequate staff training.</p>	<p>-- critical calculations independently reviewed and tested; -- programmed edits of critical data (eg purchase order extensions, totals, reasonableness tests) with queries investigated and resolved; - automatic posting fully tested. Updates to posting tables are controlled and reviewed; actual expenditure compared with projected cash flows; sub-ledgers reconciled to financial ledgers; management review against key performance indicators; structured and comprehensive staff training.</p>	<p>Current requirements.  Current requirement. Current requirement.  Minimal resource usage on ongoing basis.</p>
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