

The Auditor-General
Audit Report No.42 2008-09
Financial Statement Audit

**Interim Phase of the Audit of Financial
Statements of General Government Sector
Agencies for the Year ending 30 June 2009**

Australian National Audit Office

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of Australia 2009

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Canberra ACT
22 June 2009

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations of the accounts and records of major General Government Sector agencies as part of the audits of their 2008–09 financial statements in accordance with the authority contained in the Auditor-General Act 1997. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Interim Phase of the Audit of Financial Statements of General Government Sector Agencies for the Year Ending 30 June 2009*.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee'.

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

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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 Standard
ATO	Australian Taxation Office
AUASB	Australian Auditing and Assurance Standards Board
BCM	Business Continuity Management
BCP	Business Continuity Plan
CAC Act	Commonwealth Authorities and Companies Act 1997
CEIs	Chief Executive’s Instructions
CE	Chief Executive
CFO	Chief Finance Officer
CSA	Child Support Agency
DMO	Defence Materiel Organisation
DAFF	Department of Agriculture, Fisheries and Forestry
DBCDE	Department of Broadband, Communications and the Digital Economy
DCC	Department of Climate Change
DCITA	Department of Communications, Information Technology and the Arts
Defence	Department of Defence
DEEWR	Department of Education, Employment and Workplace Relations

DEWHA	Department of Environment, Water, Heritage and the Arts
DFAT	Department of Foreign Affairs and Trade
DIAC	Department of Immigration and Citizenship
Infrastructure	Department of Infrastructure, Transport, Regional Development and Local Government
DIISR	Department of Innovation, Industry, Science and Research
DoHA	Department of Health and Ageing
DVA	Department of Veterans' Affairs
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
Finance	Department of Finance and Deregulation
FMA Act	Financial Management and Accountability Act 1997
FMIS	Financial Management Information System
FMOs	Finance Minister's Orders
GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
GGs	General Government Sector
HRMIS	Human Resources Management Information System
IASB	International Accounting Standards Board
IT	Information Technology
JCPAA	Joint Committee of Public Accounts and Audit
PM&C	Department of the Prime Minister and Cabinet
RET	Department of Resources, Energy and Tourism
Treasury	The Department of Treasury

Glossary

System availability	Information systems are available and usable when required, and can appropriately resist attacks and recover from failures.
Confidentiality	Information is observed by, or disclosed to, only those who have a right to know.
Control activities	The policies and procedures that ensure management directives are carried out and the necessary actions are taken to address risks to achieving entity objectives.
Control environment	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. It is the foundation for effective internal control, providing discipline and structure.
Governance	A set of responsibilities and practices exercised by executive management with the goal of providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that an entity's resources are used responsibly.
Information security	The protection of information and information systems. Information security encompasses all infrastructure that facilitate its use – processes, systems, services and technology. It relates to the security of any information that is stored, processed or transmitted in electronic or similar form, and is also defined as the preservation of confidentiality, integrity and availability of information.

Integrity	Information is protected against unauthorised modification or error so accuracy, completeness and validity are maintained.
Purchase to Pay	This accounting cycle includes a number of processes associated with the ordering, receipt, payment of invoices and management of vendors.
Stakeholder	A person or a party who has either a responsibility for, a legitimate interest in, or an expectation from the agency.

Foreword

This report is designed to provide assurance to the Parliament that the systems, controls and processes that are in place in Australian Government agencies¹ are operating in a way that allows agencies to prepare financial statements that fairly report their financial performance and position at year end.

The report outlines the results of the audit coverage of key financial systems and controls in 26 agencies that represent some 95 per cent of total General Government Sector² (GGS) revenues and expenses. The audit coverage undertaken forms an integral part of our audit of the 2008–09 financial statements of these agencies. The 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. The report also discusses contemporary issues and developments that impact on public sector accounting and auditing.

At the individual agency level, a report on the results of our audits is provided to each agency Chief Executive and Audit Committee. Our reporting arrangements act as a catalyst for improvement and provide a stimulus to agency management for the resolution of issues, where this is warranted.

The results of the interim phase of our 2008–09 financial statement audits represent a continuation of the reduction over recent years in the number of significant and moderate risk audit findings. It is also a reflection of the maturity of the control regimes in the majority of agencies, notwithstanding a number of environmental factors that have affected agencies in 2008–09. Our audits do, however, continue to identify control weaknesses in a number of areas particularly relating to agencies' IT control environments, business continuity management, the management of assets and reconciliations between key financial systems.

¹ 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.

² 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 and other compulsory levies. This report covers the portfolio departments and other major GGS entities that comprise approximately 95 per cent of total GGS revenues and expenses.

A significant environmental factor impacting agencies' operations is the Global Financial Crisis (GFC). In response to the GFC, the Government has announced a range of measures designed to stimulate economic growth. A number of these measures will result in a significant increase in expenditure by particular agencies and others will require additional disclosures in agencies' financial statements. It is pleasing to note that the majority of agencies have considered the potential impact of the GFC on their operations, risk profile and financial statements, including the likely impact on income streams and asset and liability valuations.

The GFC has led to a significant fall in interest rates during 2008–09. This fall has impacted on the valuation of a large number of assets and liabilities held by Australian Government entities, whose value is affected by market conditions. This situation and the measures announced by the Government have resulted in significant additional workloads for some agencies and the ANAO across a number of areas. It can be expected that volatile market conditions will continue for some time and the ANAO will be giving additional attention to the financial implications of the GFC, particularly the valuation of certain assets and liabilities, as part of our 2008–09 and future financial statement audits.

In 2008, the Council of Australian Governments (COAG) agreed to a new framework for federal financial relations. A component of these reforms is to simplify the payment of Specific Purpose Payments and National Partnership Payments to the States and Territories through a single monthly payment from the Treasury to State Treasuries. The full financial statement implications of these new arrangements will be a focus of our 2008–09 final audits of impacted agencies, in particular the Treasury.

The financial reporting framework in 2008–09 has remained relatively stable, reflecting, in part, the International Accounting Standards Board's (IASB) decision to limit changes in accounting standards applying before 1 January 2009. The main exception has been in the area of the harmonising the two accounting frameworks under which Australian governments report at the aggregate level – Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP). The new accounting standard to implement this change, AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, came into effect from 2008–09.

In response to the GFC, international standard setters are seeking to improve requirements for the reporting of financial instruments. The IASB and the

United States Financial Accounting Standards Board are also reviewing the conceptual framework that underpins accounting standards. From 2009–10, there will be a greater number of changes to Australian Accounting Standards as the IASB increases its level of activity. At the national level, the Australian Accounting Standards Board (AASB) is continuing its review of standards relevant to the public sector.

The ANAO's focus on key aspects of legislative compliance as an integral part of the audit of agencies' financial statements is continuing. The ANAO's assessment to date of agencies' compliance with legislative requirements in relation to annual appropriations, special appropriations, annotated appropriations, special accounts and the investment of public moneys has indicated that agencies are continuing to give appropriate attention to meeting their financial legislative compliance responsibilities.

To assist agencies to manage their financial management and related responsibilities, in June 2009 the ANAO published a Better Practice Guide, *Business Continuity Management: Building resilience in public sector entities*. Two further Guides, *The Preparation of Financial Statements by Public Sector Entities*, and *SAP ECC 6.0 Security and Control* are due to be released later this month.

The work effort involved in our interim audit coverage is substantial and is increasing as our coverage is enhanced to reflect changes in the risks faced by agencies in 2008–09. Based on the work completed during the interim audit phase, we are well placed to complete the audits following the preparation by agencies of their financial statements after the close of the 2008–09 financial year. I would like to acknowledge the professionalism and commitment of my staff in undertaking the interim audit work that is reflected in this report. Their efforts have again ensured that the audit work program is on track, and enabled the tabling of this report in a timely manner for the information of the Parliament. I would also like to record our appreciation for the cooperation of Chief Financial Officers and other relevant agency staff in the production of this report.



Ian McPhee
Auditor-General

Summary

Summary

Introduction

1. 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 have been prepared in accordance with the Finance Minister's Orders (FMOs) and whether they give a true and fair view of the matters required by those Orders.
2. Our interim audits of agencies encompass a review of governance arrangements related to agencies' financial reporting responsibilities, and an examination of relevant internal controls, including information technology system controls. An examination of such issues is designed to assess the reliance that can be placed on internal controls to produce complete and accurate information for financial reporting purposes.
3. This report presents the results of the interim phase of the 2008–09 financial statement audits of all portfolio departments and other major General Government Sector (GGS) agencies that collectively represent some 95 per cent of total GGS revenues and expenses. The agencies covered by this report are listed at Appendix 1.
4. All ANAO findings have been reported to agency management and summary reports provided to the relevant Minister(s). In addition, our audit processes provide for audit issues identified to be formally reported to agency Chief Executives and their respective Audit Committees.
5. Chapter 1 of this report discusses a number of recent developments in the accounting and auditing frameworks designed to improve the overall quality and comparability of entity financial reports for 2008–09 and subsequent years.
6. Observations relating to various elements of agencies' internal controls (including the control environment, the risk assessment process, control activities and monitoring of controls) are discussed in summary form in Chapter 2. This chapter includes a discussion of audit findings over the period 2005–06 to 2008–09.
7. Findings relating to the audit of Information Technology (IT) systems focusing on the IT control environment, IT security, systems delivery and

application controls in financial management information systems and human resource management information systems are discussed in Chapter 3.

8. Chapter 4 outlines, for each agency, details of business operations; governance arrangements relevant to the agency's financial statements; factors impacting on the agency's financial reporting risks; estimated key financial figures and average staffing levels for 2008–09, and significant and moderate risk issues identified by our 2008–09 interim audits.

Financial statement audit coverage

9. A central element of the ANAO's financial statement audit methodology, and the focus of the interim phase of our audits, is a sound understanding of an agency's internal controls. To do this, the ANAO uses the framework contained in the Australian Auditing Standards ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. The key elements of internal control, as discussed in ASA 315, are the control environment; the risk assessment process; information systems, including the related business processes relevant to financial reporting, and communication; control activities and monitoring of controls.

10. The final phase of most audits will be completed in the period July to September 2009. Consistent with past practice, a second report will be tabled in the Parliament in December 2009 following completion of the financial statement audits of all entities for 2008–09. The ANAO will also report, at that time, on any additional control issues arising from the final audits.

11. The ANAO rates its audit findings according to a risk scale. Audit findings that pose a significant risk to the entity and that should be addressed as a matter of urgency, are rated as 'A'. Findings that pose a moderate risk are rated as 'B'; these should be addressed by entities within the next 12 months. Findings that are procedural in nature, or reflect relatively minor administrative shortcomings, are rated as 'C'.

Control environment

12. 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.

13. Consistent with past findings, 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 agencies' control environment particularly in the areas of risk assessment, legislative compliance and financial system controls. No instances of non-compliance with key elements of the financial framework have been identified in our interim audits. The Certificate of Compliance process, introduced in 2006–07, has resulted in an ongoing focus on wider compliance issues.

Risk assessment process

14. An understanding of an agency's risk assessment framework is an essential element of the ANAO's financial statement audits. Agencies are expected to manage the key risks specific to their environment and our interim audits include a review of controls relating to risks that may have a material impact on agencies' financial statements. The ANAO found that the majority of agencies have a well-established risk assessment process and the results are generally reviewed by audit committees.

15. Important elements of the risk assessment process common to all agencies are business continuity and fraud control management. Our audits noted that a number of agencies did not have a current organisation-wide Business Continuity Plan that had been endorsed by the agency executive. In addition, some agencies did not review, update or test these plans as part of normal business practice. All agencies have in place fraud control plans prepared in accordance with the Commonwealth Fraud Control Guidelines. A small number of agencies needed to establish mechanisms for assessing the effectiveness of these plans.

Information systems

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

17. During the interim phase of the 2008–09 financial statement 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 to the integrity of financial information presented in agencies' financial statements.

18. The ANAO noted improvements in a number of agencies' IT control environments since 2007–08. Most noticeable has been the implementation of more effective IT security, incident and problem management procedures. These improvements have enhanced the overall level of security and integrity of key financial systems. However, our audits noted continuing weaknesses in a number of agencies in the management of special or privileged users including a failure to log the activities of these users. The ANAO also observed that many agencies did not review their change management procedures on a regular basis. However, our audits continue to identify a range of IT control weaknesses in some agencies relating to security and management controls in both FMIS and HRMIS systems.

Control activities

19. The results of the 2008–09 interim audit phase indicated that, overall, control activities relating to financial and accounting processes have been maintained at an effective level. The total number of significant and moderate risk audit findings has decreased, continuing the trend over recent years. Control issues identified by our audits related to areas such as: the management of assets including stocktakes, the maintenance of asset registers and the capitalisation of expenditure; business continuity management; reconciliations between key financial statements; credit card expenditure and the approval of expenditure. A total of 280 Category A, B and C findings were identified from our interim audits, a small reduction compared with 2007-08.

Monitoring of controls

20. Many activities undertaken by an agency contribute to their regime of monitoring controls. These include quality assurance arrangements, internal and external reviews, control self-assessment processes, and internal audit. The ANAO noted that control self-assessment arrangements, first introduced by a number of agencies to assist in meeting their responsibilities to provide a Certificate of Compliance in respect of 2006–07, has become an integral part of agencies' control regimes. Internal audit was also continuing to have a key role in some agencies in assisting in the Certificate of Compliance process.

Summary of audit results

21. Most agencies had areas of their financial control environment that required attention although our interim audits found there had been an overall improvement in agencies' financial and related controls. This is reflected in a

reduction in the number of significant (Category A) and moderate risk (Category B) findings.

22. A summary of the trend in Category A and B audit findings between 2007–08 and 2008–09 is outlined below:

- there were two agencies with Category A audit findings in 2008–09 and four agencies in 2007–08;
- the total number of Category A audit findings in 2008–09 is three compared with ten in 2007–08;
- the total number of Category B audit findings across all agencies decreased from 84 in 2007–08 to 65 in 2008–09; and
- there was a decrease in the number of Category B audit findings in eight agencies; eight showed an increase; the number of Category B audit findings in two agencies remained the same as in 2007–08; and seven agencies had no Category B findings in either 2007–08 or 2008–09.

23. A summary of Category A and B audit findings by agency is provided in Chapter 4.

1. Financial Reporting and Auditing Frameworks

This chapter provides commentary on recent developments in the financial reporting and auditing frameworks under which the Australian Government and its reporting entities operate. The frameworks are illustrated at Appendices 2 and 3 of this Report.

Introduction

1.1 The Australian Government's financial reporting framework is based, in large part, on standards made independently by the Australian Accounting Standards Board (AASB)³. This framework is designed to meet the decision-making and accountability needs of financial report users.

1.2 This chapter outlines progress being made in relation to the continuing improvement of public sector financial reporting. Matters addressed include the introduction of financial reporting harmonised with Government Finance Statistics, the development of standards for reporting by small and medium-sized entities, the AASB's short-term project on accounting for grants and the reporting of ministerial and executive remuneration.

1.3 The chapter also discusses the global financial crisis and the Australian Government's commitment to introduce the Carbon Pollution Reduction Scheme as significant developments that are likely to influence the Australian financial reporting framework in the future.

1.4 The ANAO's auditing framework for Australian Government reporting entities is based on the standards made by the Australian Auditing and Assurance Standards Board (AUASB)⁴. This chapter also outlines progress being made in redrafting and revising these standards to achieve greater clarity, following the completion of a similar project by the AUASB's international equivalent, the International Auditing and Assurance Standards Board (IAASB).

³ Since 1 January 2009 the Auditor-General has been a member of the Australian Accounting Standards Board.

⁴ Until 2008 the Auditor-General was a member of the Australian Auditing and Assurance Board and the International Auditing and Assurance Standards Board.

Developments in the public sector reporting framework

GAAP/GFS harmonisation

1.5 Until recently, the Australian Government presented its annual budget mainly in accordance with the Government Financial Statistics (GFS) framework of the Australian Bureau of Statistics, while its audited financial statements were prepared in accordance with Generally Accepted Accounting Principles (GAAP).

1.6 While there are similarities between the GFS and GAAP reporting frameworks, there are also significant differences. In 2007, the AASB released AASB 1049 *Whole of Government and General Government Sector Financial Reporting* with the objective of harmonising GFS and GAAP reporting.

1.7 AASB 1049 applies to the Australian Government from 2008–09. Key requirements of the standard include:

- application of all other Australian Accounting Standards, except as specifically varied;
- application of the principles and rules in the Australian Bureau of Statistics' GFS manual,⁵ where they do not conflict with GAAP;
- reporting, on the face of the primary statements, of specified key fiscal aggregates⁶ used in GFS, measured in accordance with GAAP;
- where the measurement of a key fiscal aggregate using the GFS basis differs, a reconciliation between the GAAP and GFS measures;
- presentation of original budgeted financial statements and explanations of major variances between budget and actuals, but only where budgeted financial statements are tabled in Parliament;
- production of a separate financial report for the General Government Sector⁷; and

⁵ Australian System of Government Finance Statistics: Concepts, Sources and Methods, 2005, (latest issue released 31 July 2006), available on the ABS website <<http://www.abs.gov.au>>

⁶ The key fiscal indicators required by AASB 1049 are: net worth; net operating balance; total change in net worth (before transactions with owners); net lending/borrowing; and cash surplus/deficit.

⁷ Government Finance Statistics divides the whole of government into three sectors: General Government, Public Financial Corporations and Public Non-financial Corporations. The General Government Sector essentially includes all government units not providing goods and services for the market.

- in the whole of government report, presentation of key fiscal aggregates and other financial information by GFS sector.

1.8 Although the Australian Government adopted many elements of AASB 1049 in its Final Budget Outcome report for 2007-08, it has not made a final decision on the adoption of that standard for its annual audited financial statements. Full adoption of AASB 1049 would result in the availability to the Parliament and the public, for the first time, of a single audited set of whole of government financial statements that reports the government's performance against its budget targets in accordance with Australian Accounting Standards.

1.9 Tasmania and the Northern Territory adopted AASB 1049 for 2007-08 and there is an expectation that the remaining states and territories will implement the full requirements of the standard for 2008-09.

1.10 AASB 1049 raises a number of issues for audit offices relating to auditing of GFS measurements and explanations for variances between budget and actual figures. The ANAO has been working with the ABS to develop a detailed understanding of the GFS framework and how it differs from GAAP. AASB 1049 will place increase demands on ANAO in terms of audit skills and the resources required to complete the audit and allow publication of the 2008-09 whole-of-government financial statements by early December 2009.

1.11 The next and final phase of the GFS/GAAP harmonisation project is to consider the application of those requirements to entities within the General Government Sector. The AASB released an exposure draft in January 2009 with proposed application to reporting periods beginning on or after 1 July 2010.

Accounting Standards for Small and Medium-sized Entities

1.12 Australian Accounting Standards are largely based on standards issued by the International Accounting Standards Board (IASB), known as International Financial Reporting Standards (IFRS). The IASB has commenced a project to reduce the burden of financial reporting requirements on small to medium sized entities (SMEs). The goal of this project is the development of a stand-alone accounting standard with simplified reporting requirements for SMEs.

1.13 The IASB has previously released a draft standard for comment from constituents. This draft standard is solely for for-profit entities; the AASB has expanded its scope to include public sector and other not-for-profit reporting

entities. Responses from Australian constituents indicated a general consensus on the need to reduce the reporting burden on SMEs in Australia.

1.14 For the not-for-profit public sector, the AASB has tentatively decided on a two tier approach. The first tier would require that financial reports at federal, state and territory level apply full Australian equivalents to IFRS. The second tier would allow each jurisdiction to apply to its not-for-profit entities either full Australian equivalents to IFRS, IFRS for SMEs as adopted in Australia, or a regime of full IFRS recognition and measurement requirements with limited specified disclosures which are yet to be determined by the AASB.⁸ In the Australian Government's case, it would be the Finance Minister who would determine the policy for Australian Government not-for-profit entities.

1.15 The adoption of simplified reporting for small to medium sized entities may provide an opportunity for some Australian Government entities to reduce their administrative workload, whilst preserving appropriate disclosures to satisfy the needs of the users, in particular the Parliament.

1.16 The AASB expects to release an Australian Accounting Standard on this topic in March 2010.

AASB review of its public sector-specific standards

1.17 The AASB, in its Public Sector Policy Paper, has set out priorities and a timetable for its review of standards⁹ relevant to the public sector.

1.18 The ANAO closely follows the progress of the AASB in relation to public sector specific issues under consideration. Last year we wrote to the AASB regarding its project on income from non-exchange transactions, including tax revenue and grants. This project is focussing on accounting by grant recipients. We have asked that the AASB expand this project, as a high priority, to include accounting for grants from the perspective of the grantor. Given the significant levels of grant funding provided by the Australian

⁸ AASB Action Alert 114 (23 May 2008) available at www.aasb.com.au

⁹ The AASB Public Sector Policy Paper (as at January 2009) can be found on the AASB website <<http://www.aasb.com.au>>.

Government, we see this as an important issue. The AASB will decide whether to proceed with this issue at a later stage.¹⁰

1.19 The AASB has also commenced work on requirements for not-for-profit public sector entities in relation to related party disclosures.¹¹ The Australian Accounting Standard on related party disclosures currently applies only to the private and for-profit sectors. The development of requirements for public sector entities, including disclosure of ministerial and executive remuneration, would increase the transparency of financial reporting at both the entity and whole of government level. The AASB is currently reviewing existing practices in Australian and international public sector jurisdictions. A new or revised standard is expected to be released in June 2010.

Conceptual frameworks for accounting standards

1.20 AASB standards comprise mainly Australian equivalents to the International Financial Reporting Standards (IFRS). The conceptual framework that underpins AASB standards is also largely based on the IASB's conceptual framework.

1.21 The IASB conceptual framework is currently under review by the IASB in partnership with the United States Financial Accounting Standards Board (FASB). The objective of the review is to develop a common framework that provides a sound foundation for developing future accounting standards. This is intended to lead to more useful financial reports for potential investors, creditors and others who make resource allocation decisions.

1.22 The IASB has a timetable to release discussion papers and exposure drafts over the duration of the project, culminating in a final framework document to be released in 2012.

1.23 The project has a focus on for-profit entities only. It is only in the latter stages of the project that the applicability of the framework to other entities will be considered. As a result, the International Public Sector Accounting Standards Board (IPSASB), in conjunction with the AASB and other national accounting standards boards, has embarked on a separate project for

¹⁰ AASB Minutes from meetings held on Wednesday 30 July and Thursday 31 July 2008, available at <<http://www.aasb.com.au>>.

¹¹ AASB Action Alert 116 (4 August 2008) available at <<http://www.aasb.com.au>>.

developing a Public Sector Conceptual Framework. IPSASB have released their first consultation paper in the project¹² and the project is expected to be completed in 2012.

1.24 The AASB plans to consider the implications of the early stages of the IASB conceptual framework project for the not-for-profit sector in the second half of 2009.

The global financial crisis

1.25 The global financial crisis is adversely affecting the financial results and position of reporting entities in both the private and public sectors. In these circumstances the quality and consistency of information presented in financial reports continues to be scrutinised. The Group of Twenty (G-20) Finance Ministers and Central Bank Governors meeting of 15 November 2008 called for accounting standard-setters to address immediately the valuation and disclosure of complex financial instruments and off-balance sheet vehicles, and, in the medium term, to develop a single high-quality global accounting standard for financial instruments.

1.26 International accounting standard-setters have dedicated additional resources to addressing these concerns. The IASB has issued improvements to its standards regarding disclosure of fair values and proposals to improve disclosure of off-balance sheet vehicles. The IASB has also amended its standards to allow, in certain circumstances, the reclassification of financial assets from fair value to cost; this achieves greater comparability with entities reporting under United States Generally Accepted Accounting Principles.

1.27 In March this year, the IASB and the FASB agreed to undertake an accelerated project to replace their existing financial instruments standards with a common standard that would address issues arising from the global financial crisis in a comprehensive manner. A proposal for the new standard is expected to be published towards the end of 2009.

1.28 The ANAO is keeping abreast of the financial reporting issues arising from the global economic crisis that may affect the public sector. In our audits

¹² *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: The Objectives of Financial Reporting, The Scope of Financial Reporting; The Qualitative Characteristics of Information Included in General Purpose Financial Reports; The Reporting Entity*, International Public Sector Accounting Standards Board, September 2008

of Australian Government entities for the 2008–09 financial year, we will give particular attention to the recognition, measurement and disclosure of financial instruments likely to be affected by the global financial crisis.

Carbon Pollution Reduction Scheme

1.29 In December 2008, the Australian Government released a White Paper outlining its proposed Carbon Pollution Reduction Scheme and subsequently introduced legislation into Parliament. In May 2009 the government announced that the Scheme would be phased in from 1 July 2011.

1.30 There are currently no Australian or international accounting standards addressing emissions trading schemes. The White Paper indicates that the IASB should determine the accounting requirements relating to emissions trading in Australia, and if the requirements cannot be met before the commencement of the scheme, Australian specific guidance may have to be implemented in the interim.

1.31 The IASB is currently progressing a project on accounting for rights and obligations arising from all types of emission trading schemes. It is expected that an exposure draft will be released in the second half of 2009 and a final standard issued in 2010.

1.32 The AASB has decided to await the outcome of the IASB's project before proceeding with an accounting pronouncement for application in Australia, suggesting that a final pronouncement may be introduced in Australia by 2011-12.

Developments in Auditing Standards

1.33 Section 24 of the *Auditor-General Act 1997* requires the Auditor-General to set auditing standards to be complied with by persons performing ANAO audits.

1.34 The ANAO Auditing Standards incorporate, by reference, the current versions of the standards set by the AUASB for the auditing of financial statements ('Australian Auditing Standards' or 'ASAs'). Therefore, audits conducted by the ANAO are bound by the same standards as those applying to the broader auditing profession in Australia.

1.35 The AUASB uses International Standards on Auditing (ISAs) as the basis for making Australian Auditing and Assurance 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).

1.36 On the 27 February 2009 the IAASB formally completed its clarity project which encompassed the issue of 36 ISAs. These 36 ISAs include one new standard on the communication of deficiencies in internal control and 16 standards which contain new and revised requirements. The clarity project was initiated in 2004 to improve the consistent application of International Auditing Standards worldwide. The 'clarified' ISAs will come into effect for audits of financial statements conducted under international standards for periods beginning on or after 15 December 2009.

1.37 The IAASB issued a clarity project update in October 2008, which urged those with responsibilities relating to audits of financial statements to consider implementation issues as soon as practicable. To assist with this process the update highlighted areas for general consideration which included reviews of the system of quality control, audit methodology, manuals and software; development and updating of training programs; and updating audit programs and procedures.

1.38 In response to the work undertaken by the IAASB, ASAs are currently being revised and reissued based on the new clarity format versions of the ISAs. The AUASB states this project will ensure the revised Australian standards will continue to conform to ISAs (while maintaining enforceability under Australian regulatory arrangements e.g. the *Corporations Act 2001*). It is expected that revised standards will be approved by October 2009 and be operative for audits of financial statements in Australia for periods beginning on or after 1 January 2010.

1.39 To date, 28 of an expected 38 exposure drafts have been released for comment, and of these, 18 have been cleared pending final approval. In addition to being redrafted for clarity, many incorporate new mandatory requirements. These changes will increase the ANAO's financial statement audit effort. In the case of a proposed standard dealing with special considerations for the audit of group financial statements, the number of mandatory requirements is being expanded from nine to 40 provisions.

Reporting compliance with the Government's Financial Management Framework

ANAO auditing of compliance

1.40 The ANAO continues to focus on legislative compliance as part of its financial statements audit coverage. Annual and special appropriations, annotated appropriations, special accounts and the investment of public monies are covered using targeted work programs.

1.41 The ANAO's annual performance audit work program also includes a compliance focus, usually with the inclusion of audits that continue the ANAO's examination of aspects of the Australian Government's financial framework. Compliance-oriented audits currently scheduled for 2009-10 include entities' management of the certificate of compliance process and entities' compliance with the Commonwealth Procurement Guidelines.

Changes to Financial Management Legislation

1.42 The *Commonwealth Authorities and Companies Regulations 1997* were amended with effect from 7 February 2009 to prescribe requirements for the constitution of audit committees of Commonwealth authorities and wholly owned Commonwealth companies. The new regulations do not allow senior managers or other employees to be members of the audit committee and also permit no more than one executive director to be a member.

Conclusion

1.43 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. The AASB's ongoing agenda to improve accounting standards relating specifically to public sector reporting is especially important. In particular, the full implementation of AASB 1049 by the Australian Government would result in the availability to the Parliament and the public of a single set of audited set of whole of government financial statements that reports the government's performance against its budget targets in accordance with Australian Accounting Standards. The audit of government financial statements in accordance with AASB 1049 will also place increased demands on the ANAO.

1.44 Accounting developments relating to the global financial crisis and the proposed introduction of the Carbon Pollution Reduction Scheme will also directly affect the financial reporting responsibilities of public sector entities

and the audits of entities' financial statements by the ANAO. For the duration of the global financial crisis, the ANAO will be giving particular attention to the recognition, measurement and disclosure of financial instruments.

1.45 Looking to the longer term, the development of conceptual frameworks by international accounting standard setters is potentially significant, as these new frameworks will guide the development of future accounting standards.

1.45 In the field of auditing standards, improved standards will clarify the requirements for conducting audits. However, the new standards will also incorporate many new mandatory requirements for auditors and place additional demands on the ANAO in its audits of public sector entities.

2. 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 material agencies and discusses a number of issues relevant to the 2008–09 financial statement audits.

Introduction

2.1 The Chief Executives of General Government Sector (GGS) entities subject to the FMA Act and the CAC Act are required to prepare annual financial statements and present them to the Auditor-General for audit.¹³ For large entities, the audit is conducted in two main phases—interim and final. This report focuses on the results of the interim audit phase of the 2008–09 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.

2.2 Chief Executives of FMA agencies are required to manage their affairs in a manner that promotes effective, efficient and ethical use of resources.¹⁴ While there is no equivalent legislative provision applying to CAC Act entities, the same general standard could reasonably be expected to apply. 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.¹⁵

2.3 The objective of an audit of an agency's financial statements, as identified in the Australian Auditing Standards, is to form an opinion on

¹³ *Financial Management and Accountability Act 1997*, section 49 and *Commonwealth Authorities and Companies Act 1997*, sections 9, 12, 36 and 37.

¹⁴ *Financial Management and Accountability Act 1997*, section 44.

¹⁵ *Financial Management and Accountability Act 1997*, section 49.

whether the financial statements, in all material¹⁶ respects, are in accordance with the Australian Government financial reporting framework.¹⁷ In planning the audit so as to achieve this objective, 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 report taken as a whole.¹⁸

2.4 In accordance with generally accepted audit practice, the ANAO accepts a low level of risk that the audit procedures will fail to detect whether 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 can be 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 year-end balances with third parties.

2.5 A central component of the ANAO's 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 error in an entity's financial statements and to plan an audit approach to reduce audit risk to an acceptable level. The ANAO reviews and evaluates an entity's key internal controls to assess its capacity to prevent and detect errors in business processes, accounting records and financial reporting systems. 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.

¹⁶ Australian Accounting Standard *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 report or affect the discharge of accountability by the management or governing body of the entity.

¹⁷ The key elements of this framework are set out in Appendix 2.

¹⁸ Australian Accounting Standard *ASA 200 Objective and General Principles Governing an Audit of a Financial Report*, paragraph 35.

Internal control

2.6 The ANAO uses the framework in Auditing Standard ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements* to consider how the different elements of an entity's internal controls impact on the conduct of an audit. These elements, as detailed in ASA 315, are:

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

2.7 The following discussion of these elements reflects observations arising from our review of relevant aspects of each agency's control environment and the results of our interim audits that have been formally communicated to agency management. As such it includes, where relevant, summary comments on 'A', 'B' and 'C' category audit findings.

Control environment

2.8 The control environment directly influences the way business and operations are undertaken in every entity. For this reason, the control environment 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 80 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. It is the foundation for effective internal control, providing discipline and structure.

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

- **senior management 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;
- **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 prepares budget reports, including comparison of actual results to budgets, variance analysis and relevant commentary to provide assurance about the financial performance of the agency.

2.10 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 requires for financial statement purposes.

Observations

2.11 Consistent with our findings in prior years, agencies have senior management arrangements in place to provide direction, guidance and control over their organisations. Executive management committees met regularly to plan and monitor strategic direction and performance. The majority of agencies had produced a corporate plan or similar statement that articulates the agency’s goals and objectives, and assists in measuring agencies’ progress in meeting them. A small number of agencies affected by the Administrative Arrangement Orders of 3 December 2007 and 25 January 2008 are still developing overarching corporate and strategic plans. Chief Executives and their senior management group continued to focus attention on financial, accounting and audit matters, risk management and performance outcomes.

2.12 The ANAO noted that agencies generally have mature audit committee arrangements. These include a formal charter that articulates each committee's composition, roles, responsibilities and reporting lines, regular reporting to the Chief Executive and a periodic self-assessment of performance. The membership of most audit committees now includes one or more independent members, including as Chair.

2.13 Audit committees have an important role to play in reviewing and advising on important components of corporate governance. The ANAO found that generally all audit committees have a role in:

- assessing whether management has in place a current and comprehensive risk management framework;
- reviewing the entity's financial statements and recommending their signature by the Chief Executive;
- approving the internal audit program and regularly evaluating the performance of internal audit;
- reviewing the effectiveness of legislative compliance arrangements, including the preparation of an annual Certificate of Compliance;
- reviewing fraud control plans; and
- regularly providing assurance to the Chief Executive or raising matters of concern.

2.14 Consistent with our findings in prior years the ANAO observed that agencies periodically reviewed their Chief Executive's Instructions (CEIs) with the objective of ensuring that they remain relevant. In addition, delegations and authorisations were regularly reviewed and updated.

2.15 Consistent with previous years, consideration of the financial results 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, based on information supplied by line managers. The financial information provided to the agencies' executives was generally supplemented by non-financial operational information so that a balanced view of performance was considered.

Compliance with financial legislation

2.16 The financial framework for Australian Government entities is established by the FMA Act, the CAC Act and their respective subsidiary legislation. The key feature of the framework is that the Chief Executive of each entity is responsible for the financial management of their entity, including compliance with applicable laws and associated policies.

2.17 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.

2.18 In recent years, the ANAO has increased its focus on legislative compliance as part of its financial statement audit coverage. The increased coverage involves the ANAO assessing key aspects of legislative compliance in relation to annual appropriations, special appropriations, annotated appropriations, special accounts and the investment of public monies. Audit testing includes confirming the presence of key documents or authorities, and sample testing of relevant transactions directed at obtaining reasonable assurance about agencies' compliance with the above-mentioned legislative aspects of the financial management framework. Our audits also review the results of compliance self-assessment and processes and other reviews undertaken in the context of the agencies' Certificate of Compliance.

Observations

2.19 The 2008–09 interim audits identified that most agencies continue to maintain listings of the laws, regulations and associated government policies that are relevant to their responsibilities. Agencies also now have well-established processes in place to obtain assurance from line managers regarding compliance with relevant legislative requirements to enable Chief Executives to provide an annual Certificate of Compliance.

2.20 Systems or processes for monitoring legislative compliance are in place in all agencies. Generally, audit committees are responsible for overseeing the effectiveness of legislative compliance arrangements, particularly in relation to financial management requirements with the internal audit function often assisting with monitoring.

2.21 Agencies also have established a variety of mechanisms to communicate the importance of compliance with legislation through documents such as their Corporate Plan, Chief Executive's Instructions, Fraud

Control Plan and delegations, as well as conducting targeted training or induction courses.

Other impacts on agencies' operations

2.22 There have been some significant events that have affected the operations and control environments of a number of agencies during 2008–09. These include the Global Financial Crisis and the Council of Australian Governments (COAG's) federal financial framework reforms that were agreed on 1 January 2009 in relation to National Specific Purpose Payments (SPPs) and National Partnership payments (NPs) to the States and Territories. A discussion of these events in the context of agencies' financial statements is included below. Also included is a discussion about the management of payments to suppliers in the light of new requirements relating to small business.

Global Financial Crisis (GFC)

2.23 ANAO Audit Report No.14 2008–09, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2008*, described the significant disclosures included in the 2007–08 Consolidated Financial Statements (CFS), including those as a consequence of the GFC. These particular disclosures referred to a number of measures announced by the Government in response to the GFC including Government guarantees of deposits and wholesale funding arrangements. Since that report, the Government has made further announcements in response to the global financial crisis, including:

- the provision of liquidity to car dealer financiers who have encountered financing difficulties, through the establishment of AusCar;
- the temporary guarantee of state and territory government borrowings;
- the provision of liquidity support for viable commercial property assets in Australia, through the establishment of Australian Business Investment Partnership Limited (ABIP Ltd);
- plans to construct or upgrade a building in each of Australia's 9,540 schools;
- plans to build more than 20,000 new homes, including for defence personnel; and

- one off cash payments of up to \$900 to a range of eligible recipients, including families, single workers, students, drought effected farmers and others.

2.24 The impact of the range of Government measures relating to the GFC on individual agencies' operations and financial statements will vary according to the nature of each measure. A number of measures will result in a significant increase in expenditure by particular agencies, while others will require separate note disclosures in the financial statements of some agencies in respect of government guarantees and other measures. Audit enquiries have identified that the majority of entities covered by this report have considered the potential impact of the GFC on their operations, risk profile and financial statements, including the likely impact on income streams and asset and liability valuations. Agencies' considerations have varied from formal analysis presented to, and endorsed by, senior management and audit committees, to informal discussions within agencies. It is sound practice for agencies to consider the risk of misreporting in relation to all financial balances and disclosures that may be material, including the impact of significant environmental factors.

2.25 The GFC has led to a significant fall in interest rates during 2008–09. This fall has impacted on the valuation of a number of large assets and liabilities held by Australian Government entities, as the values of these assets and liabilities are affected by interest rate variations and other factors. Examples include investments held by the Future Fund, commonwealth government securities on issue, and long-term assets and liabilities discounted to present value using the Government bond rate or other market-based yields, including the Australian Government's superannuation liability, concessional loans such as the Higher Education Loan Program and employee provisions. The decrease in the government bond rates will result in an increase in these latter provisions. This in turn will increase employee expenses and result in a number of agencies incurring operating losses in 2008–09. Finance has obtained approval from the Finance Minister of losses incurred by agencies as a result of decreases in bond rates and has advised that, at the date of preparation of this report, 61 losses caused by a decrease in bond rates had been approved.

2.26 The Commonwealth superannuation funds¹⁹ and the Future Fund also invest in private equities, for which it is inherently difficult to obtain up to date and accurate valuations, due to the nature of these investments. These difficulties become more pronounced in times of market volatility. Another area that is generally more difficult in volatile economic conditions is the assessment of the likelihood of recovery of debts owed to the Australian Government, as increasing unemployment can negatively impact the Government's ability to recover debts.

2.27 The above-mentioned new measures and the effect of market movements have resulted in additional workloads for some agencies and the ANAO. As outlined in Chapter One of this report, the International Auditing Standards Board has issued guidance to auditors in respect of risks related to the valuation of assets and liabilities. The Australian Auditing and Assurance Standards Board has also issued guidance on auditing considerations in an uncertain economic environment. In some complex areas, the ANAO is seeking expert assistance, particularly in the areas of business and investment valuation, the impairment of financial assets and actuarial assessments. Any new measures entered into, such as the guarantee of state and territory borrowings, or new entities created, such as ABIP Ltd are being reviewed by the ANAO in the context of agencies' 2008–09 financial statements.

2.28 The full extent of valuation issues, and audit considerations around the financial reporting of the implementation of a number of new government measures, will not become clear until the preparation and audit of agencies' 2008–09 financial statements. Further details of audit work undertaken in this area will be provided in our report to the Parliament on the results of our 2008–09 financial statement audits, scheduled to be tabled in December 2009.

COAG financial relations reforms

2.29 In 2008, the Council of Australian Governments (COAG) agreed to a new framework for federal financial relations. A component of these reforms is to simplify the payment of National specific purpose payments and National partnership payments to the States and Territories (States) through a single monthly payment from the Treasury to State Treasuries. Due to the legislative

¹⁹ The Commonwealth Superannuation Funds include the Commonwealth Superannuation Scheme, the Public Sector Superannuation Scheme, the Public Sector Superannuation Accumulation Plan and the Military Superannuation and Benefits Scheme

basis and appropriations under which some payments are made, transitional arrangements apply until 30 June 2009 under which some agencies will continue to make some payments. The *Federal Financial Relations Act 2009* received assent on 26 March 2009 and commenced from 1 April 2009. The Act is to provide ongoing financial support for the delivery of services by the States, through:

- General revenue assistance, including the provision of GST revenue grants, to be used by the States for any purpose; and
- National specific purpose payments, to be spent by the States on certain service delivery sectors; and
- National partnership payments, to:
 - (a) support the delivery by the States of specified outputs or projects; or
 - (b) facilitate reforms by the States; or
 - (c) reward the States for nationally significant reforms.

2.30 A number of accounting and disclosure issues remain to be resolved in the context of agencies 2008–09 financial statements and the full financial statement implications of the revised arrangements will be a focus of our 2008–09 final audits of impacted agencies, in particular, the Treasury. The outcome of this work will be reported in our report on Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2009 to be tabled in December 2009.

Management of payment to suppliers

2.31 The Government's general practice is for suppliers' accounts to be paid within 30 days of receipt of a correctly rendered invoice, unless other terms and trade are agreed. In December 2008, the Department of Finance and Deregulation issued Finance Circular 2008/10 that outlines the Government's policy relating to payments under contracts with small business that applies to FMA agencies. In summary, the policy requires:

- agencies to adopt maximum payment terms not exceeding 30 days from the date of receipt of a correctly rendered invoice in relation to payments up to and including \$5 million; and
- contracts for procurements with a value of up to \$1 million from a small business must also provide that if full payment is not made

within 30 days of receipt of a correctly rendered invoice (or a shorter period specified in the contract) the agency must pay interest on the unpaid amount.

2.32 As part of the ANAO's 2008–09 interim audit, enquiries were made about the extent to which agencies covered by this report monitor their payment performance in respect of the timeliness of payments to suppliers and steps taken by agencies to implement and comply with the requirements relating to small business.

2.33 All agencies advised the ANAO that their performance in respect of the payment of suppliers is routinely monitored and reported as part of their regular management reporting arrangements either on a weekly, monthly or quarterly basis. In the majority of agencies, these arrangements do not involve the separate monitoring of payment performance in respect of small business, in part because agencies' FMISs have not been configured to include a separate small business identifier. A number of agencies advised the ANAO that, as a result of the new requirements in relation to small business, they were taking action to separately identify small business invoices and associated payments in their FMIS. A small number of agencies indicated that it was not cost-effective for them to separately identify and monitor payment performance for small business.

2.34 Agencies also advised the ANAO that they had taken steps to revise their procurement documentation and standard contracts, and a number of agencies had also amended their Chief Executive Instructions to reflect the new small business requirements.

2.35 At the time of the audit, agencies advised the ANAO that no interest payments had been made to small business as a result of the late payment of invoices in relation to payments under contracts up to \$1 million in value.

Risk assessment process

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

2.37 The ANAO found that the majority of agencies have a risk assessment process in place that involves developing and updating risk management

plans at the organisational and work area levels. Oversight of the process is usually provided by the agency's audit committee.

2.38 Two common elements of agencies' risk management frameworks that the ANAO reviews as part of its interim audits are business continuity management and fraud control management.

Business Continuity Management

2.39 Business continuity management (BCM) is an essential business practice and an integral component of effective public sector governance. It is a unified process encompassing both business and management disciplines to provide resilience to business processes.

2.40 BCM involves the development, implementation, and maintenance of those policies, frameworks and procedures to assist an agency manage a business disruption. This capability assists in preventing, preparing for, responding to, managing, and recovering from the impacts of a disruptive event.

2.41 Defining the approach to preventing and dealing with a break in business operations is a major role of BCM, as this requires non-routine management practices. BCM involves designing business processes and information architecture to limit single points of failure, and developing contingency procedures and the steps the agency will take to recover and return to normality. It also includes defining escalation protocols, and obtaining contact details for key personnel and for other entities where an important interdependency exists.

2.42 There are two key elements to BCM, supported by a number of activities that interrelate to identify, analyse, and treat continuity risks and deal with the consequences should preventative treatments fail. The two elements are:

- Business Continuity Plan (BCP): a collection of procedures and information for maintaining service delivery, that is developed, compiled and maintained in readiness for use in a business disruption event; and
- IT Disaster Recovery Plan (DRP): the process for recovering computer systems and associated infrastructure following a disruption to services. In some cases, IT disaster recovery plans may encompass other technical facilities such as telephony.

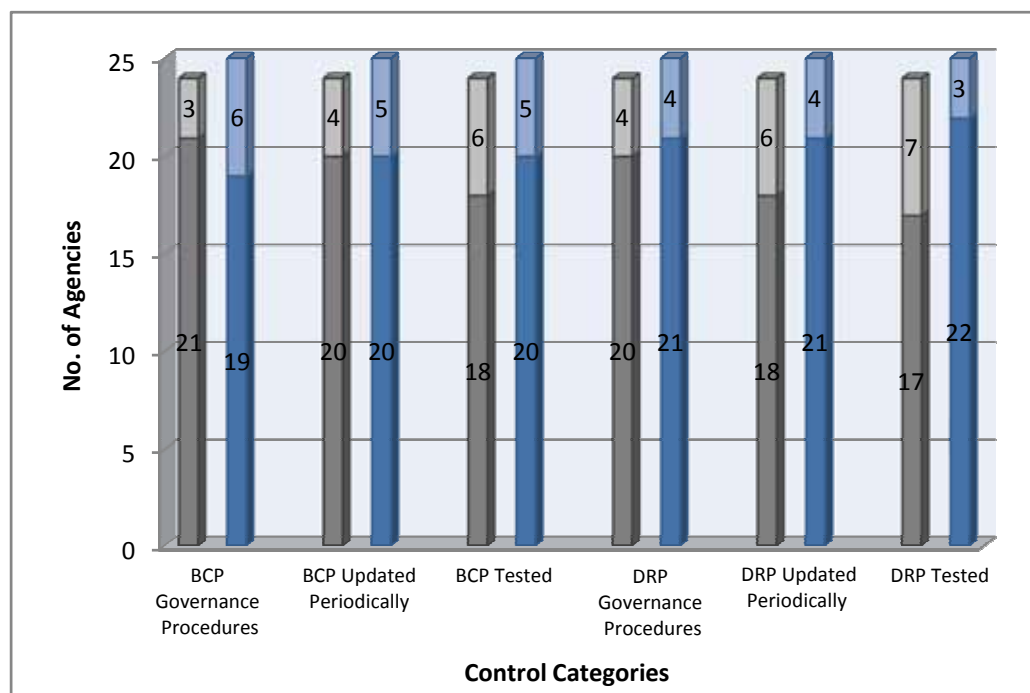
Observations

2.43 Business continuity planning continues to be an essential part of agencies ability to maintain key business functions and deliver services. As part of the interim phase of our 2008–09 financial statement audits, the ANAO assessed key BCM control activities in the context of agencies’ financial statements. The summarised results of our review of BCM controls are illustrated in Figure 2.1 below.

Figure 2.1

Assessment of business continuity and disaster recovery control objectives

2008-09: ■ Effective ■ Needs Improvement
 2007-08: ■ Effective ■ Needs Improvement



2.44 Our audits identified that governance procedures in a third of agencies did not provide for an organisation-wide BCP that is current and endorsed by the agency executive. This puts those agencies at risk of having inconsistent or outdated continuity practices and procedures, which may in turn increase the risk to agencies’ service delivery. For instance, an agency may not correctly

recover all of its current business practices and systems during a disruption, or key staff may not be aware of their roles and responsibilities during a business disruption event.

2.45 In addition, one fifth of agencies do not review, update and test BCPs as part of normal business practice. Some perform this over specific systems, but not as part of an overarching organisational BCP. This has the potential to become a serious issue over time, as the business environment is continually changing, and the types of risks to the business, and to the IT environments that support them, evolve over time. Agencies therefore require coordinated and current organisation-wide plans to be in the best position to minimise the impact of any disruption event.

2.46 However, most agencies have improved key aspects of continuity management since our review in 2007–08. In particular, more agencies now maintain the currency of their DRPs, and periodically validate them through regular testing activities. These plans are designed to assist agencies to maintain service delivery through a business disruption event, and to return to normal operations within agreed timeframes. Regular testing is a way to ensure appropriate training and effective recovery processes are established, and that no gaps in the plans exist.

2.47 Overall, our assessment of continuity management indicates agencies are aware of the importance of BCP and DRP to the continuous delivery of their services. However, some agencies have not fully embedded the establishment, maintenance, and testing of business continuity and recovery plans into their normal business activities. For those agencies, placing a greater emphasis on implementing and sustaining continuity management, as an essential business process, would provide a higher level of business resilience to disruptive events.

2.48 In June 2009, the ANAO published a Better Practice Guide, *Business Continuity Management: Building resilience in public sector entities*, to assist agencies in managing their business continuity responsibilities.

Fraud control management

2.49 *The Commonwealth Fraud Control Guidelines* (the Guidelines) outline the principles for fraud control within the Australian Government and set national

minimum standards to assist agencies in carrying out their responsibilities to combat fraud²⁰ against their programs.

2.50 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. Order 2.2 of the FMA Orders requires Chief Executives to prepare a report on fraud control for their agency at least every two years, in accordance with the Guidelines, and to provide the report to the agency's responsible Minister. All agencies are required to provide the Australian Institute of Criminology (AIC) with fraud control information for its annual report on fraud against the Commonwealth to the Minister for Home Affairs in line with the Guidelines.

2.51 The information provided by agencies is collated and a fraud annual report is provided to Government to facilitate analysis of fraud and future policy development. Unaudited data provided to the AIC for the year ended 30 June 2008 showed that:

- the Australian Federal Police investigated 396 complex cases in 2007–08 and estimated the cost of fraud for these cases to be \$145.6 million;
- 5 952 defendants were referred to the Commonwealth Director of Public Prosecutions for prosecution;
- 3 457 convictions for fraud were achieved during 2007–08; and
- there were 49 acquittals for fraud during 2007–08.

2.52 These data continue to highlight the importance of agencies effectively managing their fraud control responsibilities.

²⁰ The Commonwealth Fraud Control Guidelines define fraud against the Commonwealth as 'dishonestly obtaining a benefit by deception or other means'. This definition includes theft; obtaining property, a financial advantage or any other benefit by deception; causing a loss, or avoiding or creating a liability by deception; providing false or misleading information to the Commonwealth, or failing to provide information where there is an obligation to do so; making, using or possessing forged or falsified documents; bribery, corruption or abuse of office; unlawful use of Commonwealth computers, vehicles, telephones and other property or services; relevant bankruptcy offences; and any offences of a like nature to those listed previously.

2.53 An explanation of an auditor's responsibility for preventing and detecting fraud is provided in Australian Auditing Standard ASA 240 *The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report*, which states in paragraph 16:

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

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

2.55 In August 2004, the ANAO issued a Better Practice Guide titled *Fraud Control in Australian Government Agencies* to support the Guidelines and to provide additional information on implementation to those who have direct responsibility for fraud control management within Australian Government entities.

2.56 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 process.

Observations

2.57 Our enquiries have identified an overall improvement in agencies' compliance with the Guidelines, with fraud control planning being well established in the majority of agencies. Nevertheless, mechanisms to monitor the effectiveness of fraud controls plans are an aspect that requires further attention in a number of agencies.

Information systems

2.58 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

2.59 The ANAO observed that all agencies had governance arrangements in place that encompassed the oversight and management of their information systems and IT change processes.

2.60 The ANAO also observed that most agencies had improved their IT security, incident and problem management procedures. This has led to an overall enhancement in the integrity of key financial systems. However, the following IT controls issues warrant attention by some agencies:

- the management of special and privileged user access in both FMIS and HRMIS systems;
- the adequacy of audit logs in FMIS and HRMIS systems and;
- the need for more regular reviews of change management processes to ensure that they are updated to reflect an agency's business and technical environment.

2.61 Given the significance of information systems and the ongoing issues in this area, a detailed commentary is provided in Chapter 3.

Control activities

2.62 Australian Auditing Standard ASA 315 at paragraph 106 states:

Control activities are the policies and procedures that help ensure that management directives are carried out; for example, that necessary actions are taken to address risks that threaten the achievement of the entity's objectives.

2.63 ASA 315, paragraph 107, requires the auditor to consider whether, and how, a specific control activity, individually or in combination with others, prevents, or detects and corrects, material misstatements in classes of transactions, account balances, or financial statement disclosures. Examples of control activities include reconciliations, authorisation, segregation of duties and information processing.

2.64 Previous reports outlining the results of the interim phase of our financial statement audits have included details of audit findings for the year concerned. To better inform the Parliament about trends in audit findings over

time, this report provides aggregate details of category A, B and C findings over the last four years grouped into the following categories:

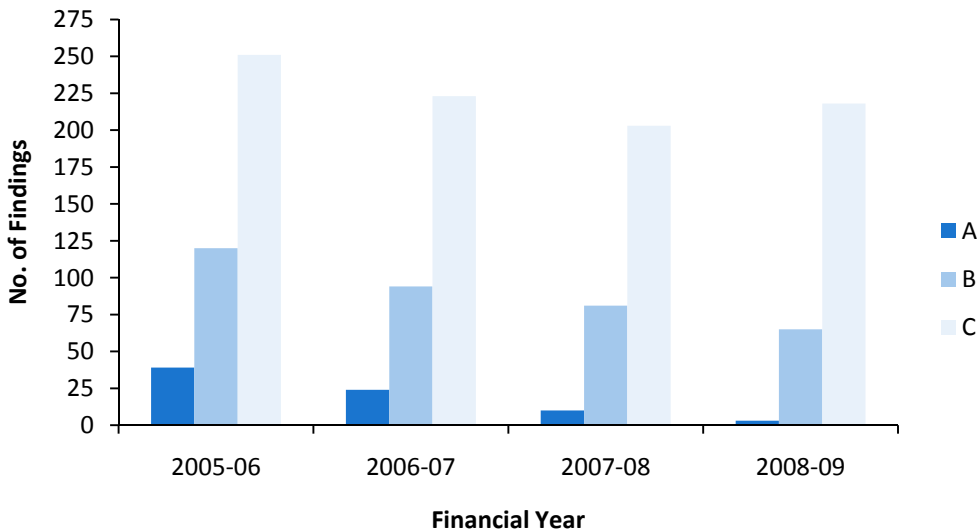
- IT control environment;
- purchases and payables;
- human resource management processes;
- grant accounting;
- accounting and control of non-financial assets;
- revenues, receivables and cash management; and
- other control matters.

Aggregate audit findings

2.65 Details of aggregate audit findings for the last four years are outlined in Figure 2.2 below:

Figure 2.2

Aggregate audit findings – all categories



2.66 Over the last four years the ANAO's interim audits have identified approximately 1300 audit findings. There has been a progressive reduction in the total number of findings over this period with the majority (68 per cent) of findings being Category C findings. There has also been a significant reduction

in the number of A and B findings, from approximately 38 per cent of total findings in 2005–06 to approximately 24 per cent in 2008–09. This reflects favourably on the general standard of financial management in agencies.

2.67 Details of audit findings by category are outlined below.

IT control environment

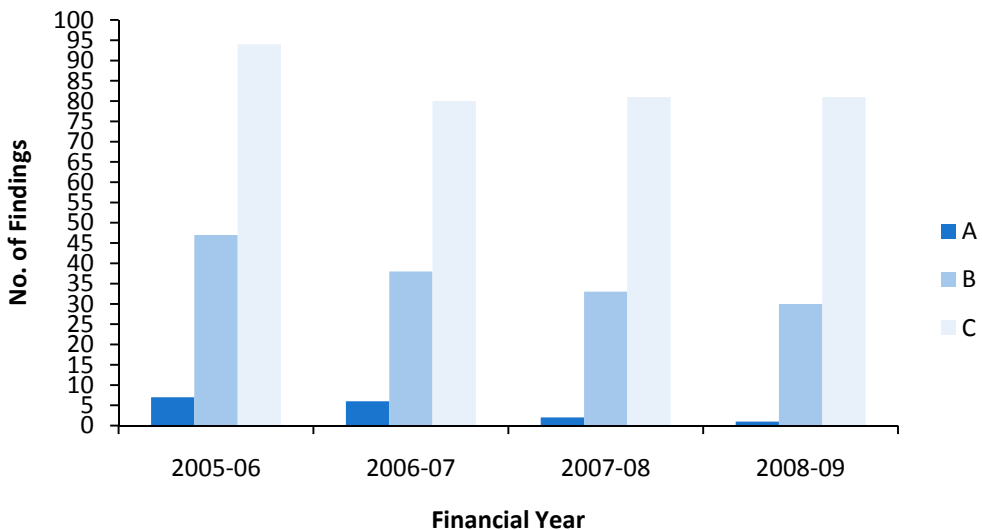
2.68 As mentioned above, the review of information systems and their related controls are examined as an integral part of an agency’s internal control environment. The main components reviewed are: IT general controls that encompass an agency’s IT infrastructure, policies, procedures and standards that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

2.69 Collectively, agencies expend several billion dollars annually on information technology.

2.70 Details of audit findings over the last four years are outlined in Figure 2.3 below:

Figure 2.3

IT control environment - aggregate audit findings



2.71 Findings in relation to agencies’ IT controls environments represent approximately 37 per cent of all findings, with some 500 findings in total over

four years. Perhaps not surprisingly given the importance of IT systems in recording and producing financial information, the number of findings in this category is the most of any category. The ANAO observed an overall improvement in the management of IT controls over the past four years, with a gradual reduction in the total number of A, B and C category findings over this period.

2.72 Our audits have noted an overall improvement in agencies' IT strategic planning frameworks and IT security management arrangements. Agencies generally have well defined IT organisational structures and identify, actively monitor and assess risks to their respective IT environments. Generally, agencies have also established effective IT change management procedures. Common areas where our audits have identified the need for improvement, include: the development of security plans for all IT systems; the periodic review of change management policies and procedures; user access controls in agencies' FMISs and HRMISs, particularly the logging and review of privileged user activities and the segregation of duties; and formalising security incident detection and reporting.

Purchases and payables

2.73 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.

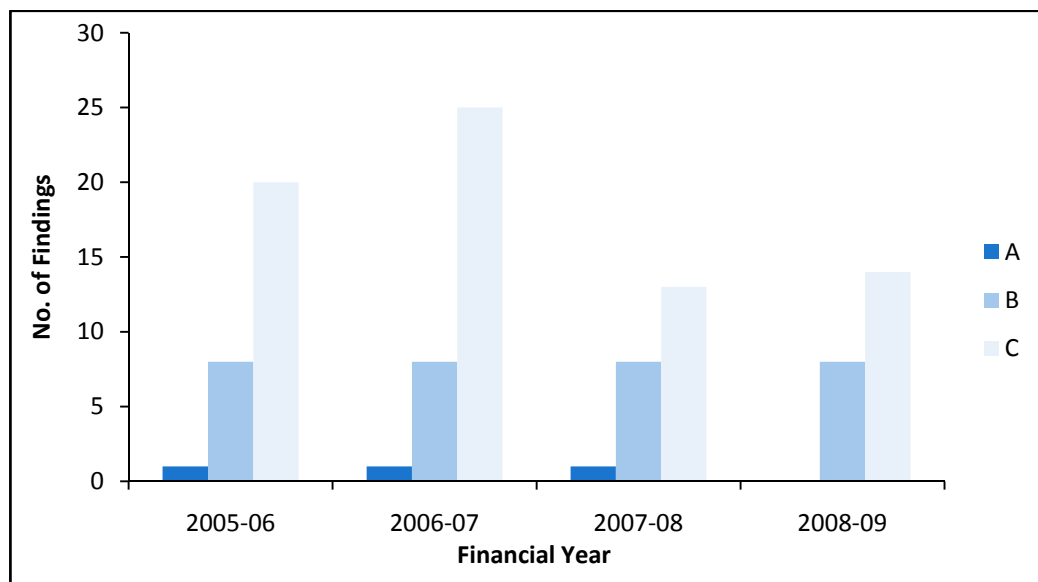
2.74 In 2007–08, the Consolidated Financial Statements (CFS) reported total supplier expenses of \$24.6 billion.

2.75 The main controls over purchases and payables, and on which our interim audit is focussed, include: approval of the commitment and expenditure of public monies in accordance with authorisations and delegations; segregation of duties; controls to prevent duplicate payments; reconciliations between the general ledger and subsidiary accounts; and controls over credit card expenditure.

2.76 Details of audit findings over the last four years are outlined in Figure 2.4 below:

Figure 2.4

Purchases and payables - aggregate audit findings



2.77 Over the last four years, agencies' controls over purchases and payables subjected to audit review have been generally effective with a relatively small number of audit findings, representing approximately eight per cent of total audit findings. The number of moderate risk (Category B) findings has remained the same while the number of low risk (Category C) findings has reduced over the last two years. Common issues identified include a lack of reconciliations of the general ledger with other accounts or key systems; inadequate segregation of duties; inadequate controls designed to prevent duplicate payments and lack of controls over credit card expenditure. Particular issues identified in our 2008–09 interim audits include the inappropriate approval of public moneys and a lack of control over credit card expenditure.

Grant accounting

2.78 Most agencies administer grant programs that involve the provision of funds to eligible recipients in accordance with legislative requirements or grant agreements. Grant recipients include State and Local Governments and community organisations.

2.79 The main controls over grants, and on which our interim audit is focussed for particular grant programs include: approval of the commitment

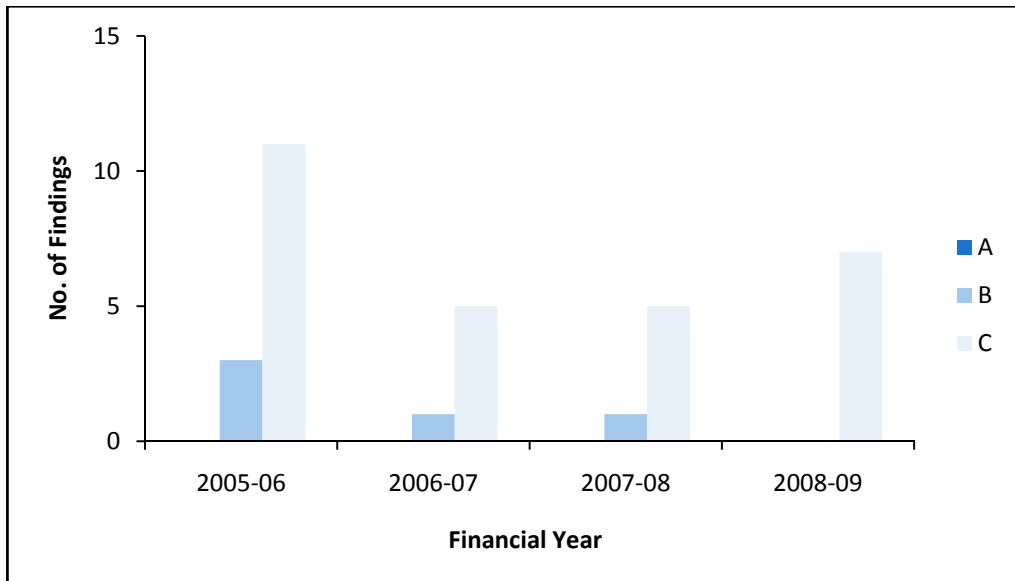
and expenditure of grants to eligible recipients; the payment of grants in accordance with funding agreements; and controls over grant acquittals.

2.80 In 2007–08, the Consolidated Financial Statements reported total grant expenditure of \$92.3 billion.

2.81 Details of audit findings over the last four years are outlined in Figure 2.5 below:

Figure 2.5

Grant accounting - aggregate audit findings



2.82 Over the last four years agencies' controls over the payment of grants subjected to audit review have been generally effective with a very small number of audit findings, representing approximately two per cent of total audit findings. Common issues identified include: inadequate monitoring of payments made under grant programs and funding agreements including the failure to acquit grants on a timely basis. Particular issues identified in our 2008–09 interim audits included the lack of reconciliations of the general ledger with grants systems and inadequate documentation to support grant payments.

2.83 Audits of the general administration and the effectiveness and efficiency of grant programs by agencies are included in the ANAO's performance audit program. These audits generally include: assessment of processes by which grant applications are sought, received and assessed; the

processes for the development and management of funding agreements with grant recipients; and how agencies assess and monitor the achievement of project and program outcomes. Over many years, our performance audits have identified 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 and the management of funding agreements.

2.84 In light of audit findings and other scrutiny including by Parliamentary Committees, in December 2008 the Minister for Finance and Deregulation announced reforms to the administration of grants, including the development of Commonwealth Grants Guidelines to provide clear rules and guidance to Ministers and administering agencies. The Minister also announced that related changes would be made to the financial framework to make it a legal requirement for Ministers and officials to follow the Guidelines and to record the reasons that individual grants have been approved. These changes are expected to come into effect on 1 July 2009.

2.85 The results of our audits will be used to inform the development of a revised Better Practice Guide on Grants Administration to be issued in 2009–10.

Accounting and control of non-financial assets

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

2.87 In 2007–08, the Consolidated Financial Statements reported total non-financial assets of some \$95.2 billion.

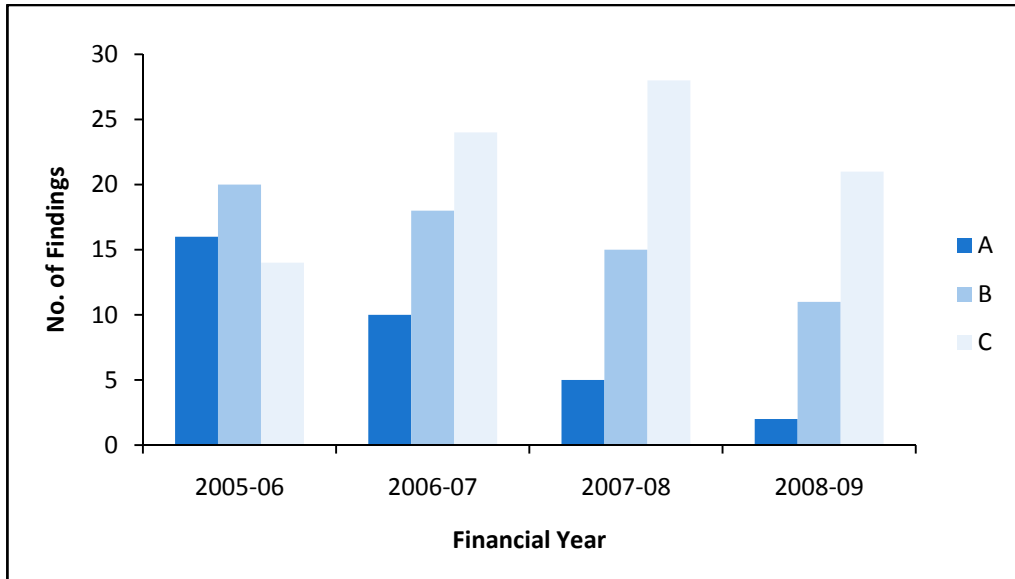
2.88 The main controls over assets, and on which our interim audit is focussed, include: the approval of the commitment and expenditure of public monies in accordance with authorisations and delegations; reconciliations between the general ledger and subsidiary asset accounts; the maintenance of a reliable 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 audits.

2.89 Details of audit findings over the last four years are outlined in Figure 2.6 below:

Figure 2.6

Asset accounting and control of non-financial assets - aggregate audit findings



2.90 Over the last four years there have been some 170 audit findings in this area representing approximately 14 per cent of the total number of audit findings. Overall, there has been a gradual reduction in total findings over this period. The substantial reduction in Category A and B findings primarily reflects the remedial actions taken by Defence and DMO to address a range of issues related to inventories and other assets. Common issues identified by our interim audits include: reconciliations between agencies' asset registers and agencies' financial systems not being completed in a timely manner; delays in the capitalisation and disposals of assets; the misclassification of assets between asset classes; the inconsistent application and a lack of clarity in policies and procedures relating to stocktakes; and the absence of a consistent policy on the useful life of assets. In addition, there was inadequate accounting for assets under construction in some agencies. Particular issues identified in our 2008–09 interim audits included inappropriate supporting documentation

and authorisation for the disposal of assets and stocktake variances not being analysed and resolved in a timely manner.

Revenue, receivables and cash management

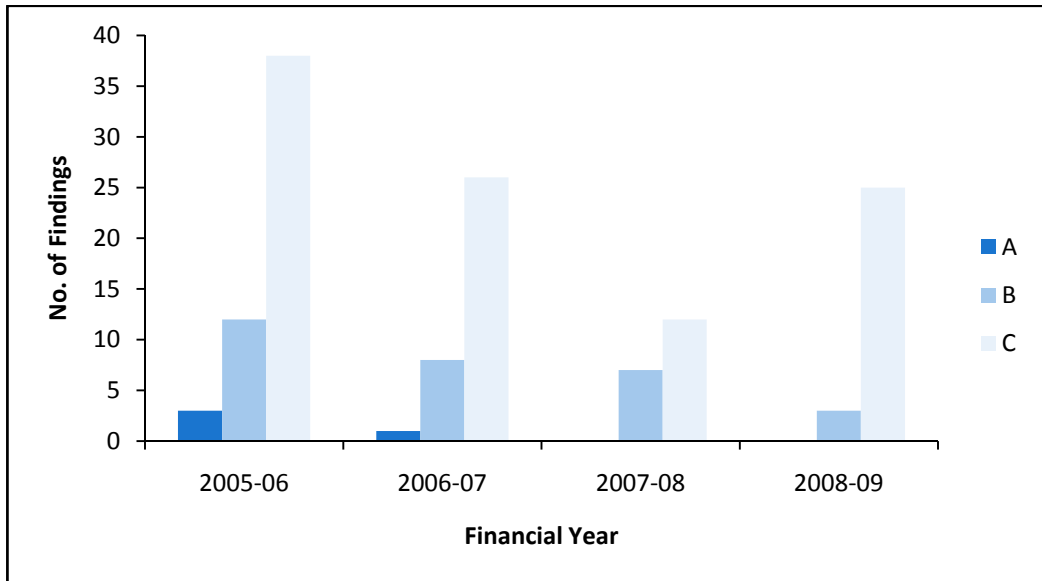
2.91 The main components of Revenue and Receivables consist of Parliamentary appropriations, taxation revenue, customs and excise duties and administered levies. Other revenue is also generated by agencies from the sale of goods and services and from interest earned from cash funds on deposit. Cash management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

2.92 In 2007–08, the Consolidated Financial Statements reported total taxation revenues of \$285.8 billion, and non-taxation revenues of \$30.7 billion and reported cash totalling \$4.2 billion.

2.93 The main controls over revenue and receivables, and on which our interim audit is focussed, 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.

2.94 The main controls over the management of cash and on which our interim audit is focussed, include: the approval to open and close bank accounts; monitoring of budgets for cash inflows and outflows; and the preparation of bank reconciliations on a regular basis by independent officers.

2.95 Details of audit findings over the last four years are outlined in Figure 2.7 below:

Figure 2.7**Revenue, receivables and cash management- aggregate audit findings**

2.96 Over the last four years, our interim audits have identified that agencies' key controls over revenue, receivables and cash have generally been effective. Nevertheless, there have been some 130 audit findings, representing approximately 10 per cent of total findings. Common issues noted include: a lack of supporting documentation and untimely completion of reconciliations between relevant revenue systems and agencies' financial management systems; the inconsistent classification of revenues; delays in completing reconciliations between the general ledger and bank statements and the clearance of discrepancies; delays in banking receipts and instances where official bank accounts were overdrawn in the absence of an overdraft facility. In 2008–09 our interim audits identified a small number a significant findings in relation to the write-off of bad debts, the processing of refunds and the accounting for passport revenue.

Human resource management processes

2.97 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 second 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.

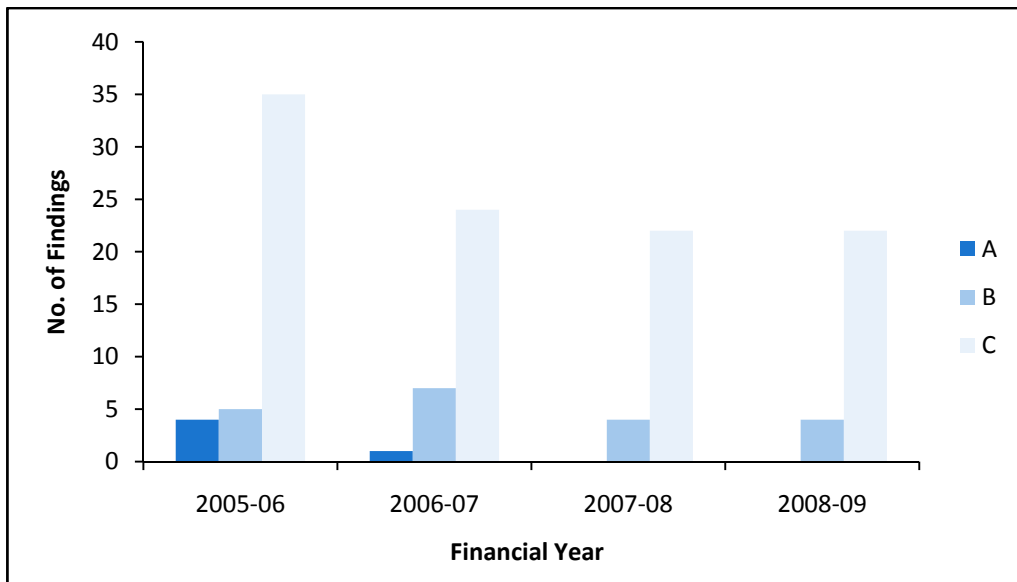
2.98 In 2007–08, the Consolidated Financial Statements reported \$30.5 billion in employee benefit expenses, including employee superannuation contributions of \$8.9 billion.

2.99 The main controls over human resource management processes and on which our interim audit is focussed, include: approvals over new starters processes; independent checks of commencements salary and personnel details entered into HRMIS; approval of changes of key HRMIS data; independent checks over payroll processes; the accuracy of leave entitlement calculations; the approval of leave final termination payments by the delegated officer.

2.100 Details of audit findings over the last four years are outlined in Figure 2.8 below:

Figure 2.8

Human resource management process - aggregate audit findings



2.101 There have been some 130 findings in this category, representing approximately 10 percent of total audit findings. Common issues noted include a lack of documentation of commencements and termination of staff including leave records not being maintained, the absence of independent reviews on separation and final payments; unapproved leave requests; errors in the

calculation of leave provisions; a lack of, or deficiencies in, documentation to support reconciliations between the HRMIS and the FMIS.

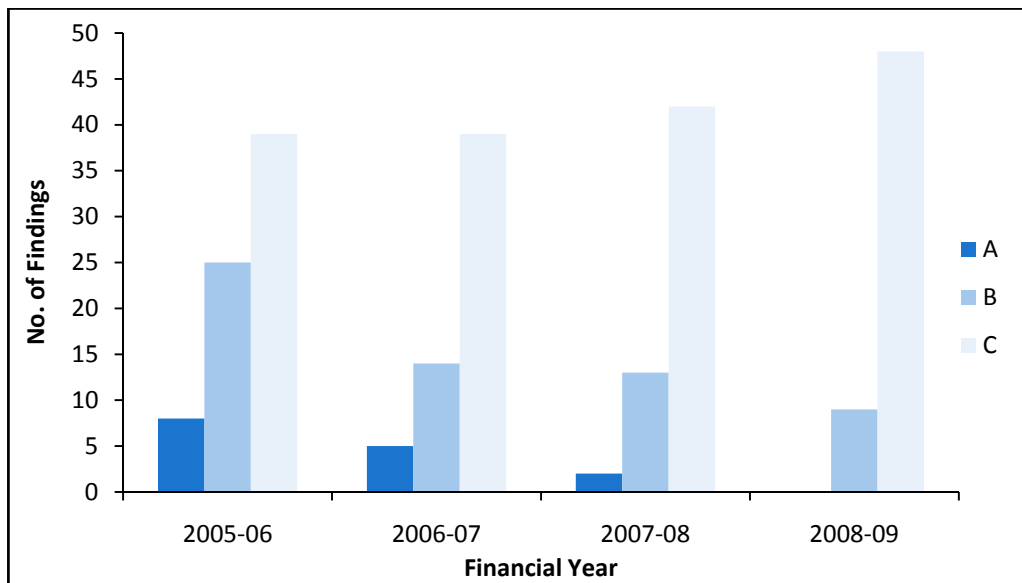
Other control matters

2.102 Our audits include a review of agencies' general control environments as they impact on agencies' financial statements and this category of findings relates to control issues that do not fall into the other categories outlined above. These issues include such matters as Business Continuity Management, the management of service level agreements and Memoranda of Understanding (MOU), and risk management and quality assurance processes.

2.103 Details of audit findings over the last four years are outlined in Figure 2.9 below:

Figure 2.9

Other control matters- aggregate audit findings



2.104 There have been approximately 240 findings in this category representing approximately 18 per cent of total audit findings. Common issues noted include: weaknesses in Business Continuity Management, particularly a lack of a comprehensive, agency-wide business continuity plans and the absence of established arrangements for the review and testing of plans (the results of our 2008–09 review of BCM are outlined at paragraphs 2.39 to 2.47 above); delays in finalising service level agreements and MOUs and gaps in accountability arrangements in agreements and MOUs in place; the absence of,

or delays in, conducting reconciliations in respect of a number of accounts or key processes; and the need to improve quality assurance or review processes.

Monitoring of controls

2.105 Australian Auditing Standard ASA 315 at paragraph 114 states:

Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Those charged with governance and management accomplish 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.

2.106 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 investment by Australian Government agencies in the internal audit function and the requirements of Australian Auditing Standards, this function is reviewed by the ANAO each year to gain an understanding of how it contributes to the overall monitoring of controls.

Internal audit function

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

2.108 As part of its financial statement coverage, the ANAO reviews the activities of internal audit in accordance with Auditing Standard ASA 610 *Considering the Work of Internal Audit*. 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, including 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.

2.109 To assist agencies in the management of their internal audit functions, in September 2007 the ANAO issued a Better Practice Guide *Public Sector Internal Audit*. The Better Practice Guide outlines the key characteristics for an Internal Audit function that will provide confidence and assurance to Chief Executives and or Boards that those financial and operational controls, which manage the organisations risks, are operating in an efficient and effective manner. It also assists management in approving the agencies performance.

Observations

2.110 The ANAO found 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. We also observed that the composition of internal audit work plans were weighted more towards assurance and compliance activities than performance activities.

2.111 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, including coverage that is used to underpin the Certificate of Compliance process. 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.

2.112 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 providing a satisfactory service.

Financial statement preparation

2.113 For 2008–09, agencies are required to submit audit cleared financial statement information including narrative note information to Finance by 15 August 2009. This is consistent with the 2007–08 financial statements deadline.

2.114 To assist agencies in achieving efficiencies in the preparation of their financial statements, in June 2009 the ANAO will publish an updated Better Practice Guide *Preparation of Financial Statements by Public Sector Entities* to provide advice to entities on approaches which can be taken to produce materially correct financial statements in a timely manner.

2.115 Agencies' financial statement preparation processes will be reviewed as part of our 2008–09 financial statement audits.

Conclusion

The results of our 2008–09 interim audits reflect, in general, the maturity of agencies' control environments and that, generally, the effectiveness of controls over finance and accounting processes in the majority of agencies supports the production of reliable financial statement information. It is clear, however, that recent Government measures and environmental impacts continue to lead to a great deal of change and high levels of activity. While there has been a steady decrease in audit findings over recent times, agencies need to continuously 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.

3. 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.

Introduction

3.1 Information Technology (IT) facilitates the way in which Australian Government agencies operate and supports the business processes that deliver services to the Australian community. The Australian Government expends several billion dollars annually on information technology.

3.2 The business processes that underpin financial statement preparation and reporting require the support of IT systems. Hence, these processes form a key component of agencies' control environments and the ongoing evaluation of the IT control environment is a core component of the overall audit process. The ANAO reviews both IT general controls²¹ and application controls²² within these environments as part of its annual financial statement audits.

3.3 This year's report includes a review of key IT control categories across agencies to provide a broad perspective of the effectiveness of the implementation and operation of key IT controls having regard to our focus on risks to the material misstatement of agencies' financial statements. The results of our audit assessment, as outlined in this chapter, are presented in this context.

3.4 The graphs that follow reflect our assessment of 25 agencies in 2008–09. Findings in relation to individual agencies are outlined in Chapter 4. Comparative figures for 2007–08 reflect the assessment of 23 agencies.

²¹ 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 ensure IT application controls were working as intended throughout the financial year.

²² 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 of agencies financial statements, particularly high transaction volume accounts.

IT control environment

3.5 The ANAO assesses the design and operation of key IT controls in agencies to determine the effectiveness of these controls, and their impact on reducing risks to the integrity of financial information presented in agencies' financial statements. The ANAO undertakes this assessment on a yearly basis in accordance with the Australian Auditing Standards²³. The accuracy, completeness, and validity of agencies' financial transactions and information are important considerations in formulating agencies' overall risk profile, and, as such, it is important that controls are well designed and operated effectively.

Table 3.1 below outlines the IT general and application control areas²⁴ and specific elements reviewed by the ANAO as part of the 2008–09 financial statement audits of agencies covered by this report.

Table 3.1

Elements of the IT control environment

<i>Control Area</i>	<i>Control Element</i>	<i>Description</i>
IT general controls	IT Security Management	The policies, plans, and access management practices that provide for the protection of, and authorised access to, information.
	Incident and Problem Management	The procedures used to ensure resolution of issues and that IT systems remain operational and meet agencies' business needs.
	IT Change Management	The procedures used to develop, deliver, and maintain IT systems that meet the business needs of agencies.

²³ Australian Auditing Standards, *ASA 315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*, AUSAB April 2006, <<http://www.auasb.gov.au>>.

²⁴ Given the extensive number of individual controls assessed by the ANAO each audit, for the purposes of this report we group controls into a series of elements, for example IT Security or IT Change Management, and then into control categories within each element.

Control Area	Control Element	Description
IT application controls	Financial Management Information System	Integrated processes that assist users to manage and interpret financial transactions and information flows to aid in agency decision-making.
	Human Resource Management Information System	Integrated processes used to capture, process, report and monitor human resource business transactions and support human resource management processes.

3.6 As part of the overall audit approach, a key step for the ANAO each year is an assessment of significant changes to agencies' control environments. By its nature, the IT control environment is subject to ongoing 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 can often have a fundamental impact on the underlying IT control environment.

3.7 For the 2008–09 audits the ANAO assessed, where applicable, major technology change activities within agencies, including agencies' responses to the *Review of the Australian Government's use of Information and Communications Technology* (the Gershon Review²⁵). The purpose of this assessment was to understand the impact of these activities on agencies' IT control environments and, where necessary, tailor our audit procedures accordingly. Our focus was on aspects of the IT control environment that could result in financial statements being materially misstated.

3.8 Technology change activities often have extended delivery timeframes and the effect of such changes can take some time to be evident. As such, during the 2009–10 audits the ANAO will again monitor progress of key IT initiatives and assess the impact of these on agencies' control environments.

²⁵ The Gershon Review was undertaken in 2008 at the request of the Australian Government to identify areas for efficiency improvement in the management of IT within and between agencies. The review's recommendations were all subsequently agreed to by the Government. In implementing these recommendations, agencies are proposing, or are in the process of implementing, a number of major IT initiatives to deliver improved IT efficiencies. These initiatives could result in significant changes to the future management and operation of technology environments in some agencies.

IT general controls

3.9 General controls are the foundation of agencies' IT control structures. They act to ensure the reliability and integrity of information and outputs generated by technology systems. General controls continue to evolve with agencies as their technology environments support and respond to business changes initiatives. The ANAO's review of general controls focused on the controls present in the IT environment surrounding those systems that process financial transactions and information.

IT security management

3.10 The administration of government programs often involves agencies managing, protecting and preserving large amounts of financial and personal information. The integrity of such data can be threatened by an IT security incident, and hence risk the accuracy and completeness of agencies' financial information. Any incident can also pose a risk to the legal, privacy, and operational responsibilities of agencies, and result in loss of public confidence.

3.11 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 resources that agencies must meet in their operations are detailed in the *Australian Government Protective Security Manual (PSM)*²⁶ and the *Australian Government Information and Communications Technology Security Manual (ACSI 33)*.²⁷

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

- security governance structures, policies and procedures;
- network security processes and procedures;
- security awareness and training;

²⁶ The *Australian Government Protective Security Manual (PSM)* sets out the policies, practices, and procedures that provide for an appropriate protective security environment.

²⁷ The *Australian Government Information and Communications Technology Security Manual* complements the PSM by providing policies and guidance to assist Government agencies to achieve an assured IT security environment.

- security monitoring and reporting;
- user access management, identification and segregation of duties; and
- physical security processes and procedures.

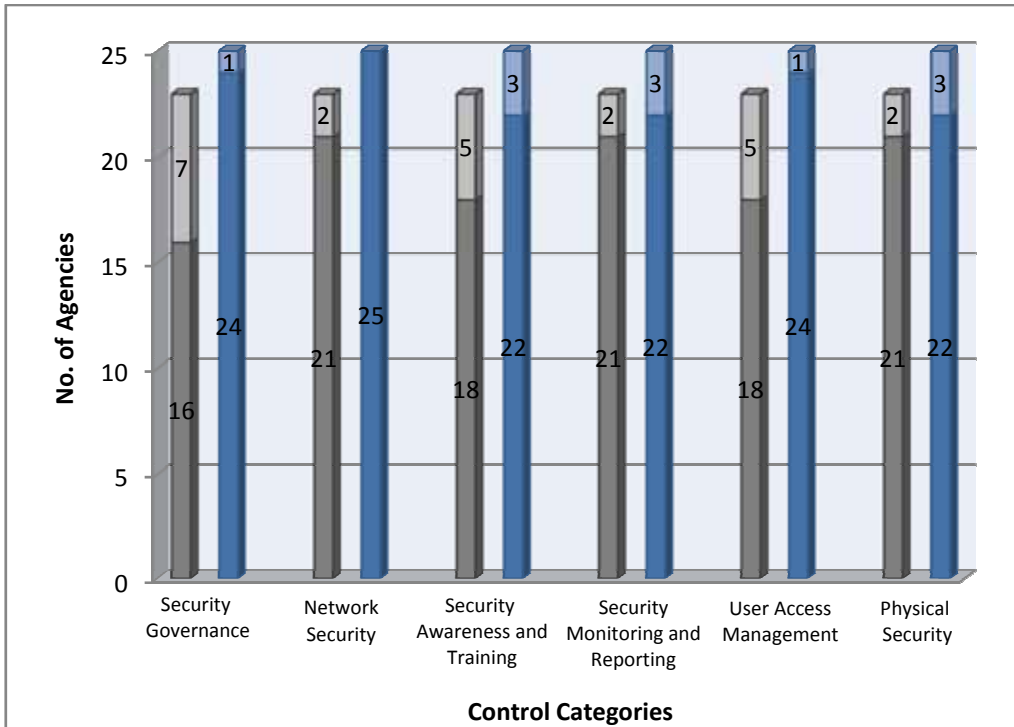
Observations

3.13 A summary of the ANAO’s assessment of the effectiveness of security control categories within agencies, in the context of agencies’ financial statements, is provided in Figure 3.1 below:

Figure 3.1

Assessment of IT security control categories

2008-09: ■ Effective ■ Needs Improvement
 2007-08: ■ Effective ■ Needs Improvement



3.14 Overall, security controls implemented by agencies have shown a significant improvement over the past twelve months. In particular, security governance activities have improved significantly. In 2007–08, almost a third of agencies did not have a current and management endorsed security

governance structure in place. This year almost all agencies had established effective security governance controls.

3.15 Similarly, agencies have improved their network security procedures to provide authorised access and control of remote access information flows. The ANAO found this year that, in general, agencies have also improved their security awareness and training practices and procedures.

3.16 However, in a small number of agencies, practices relating to the monitoring and reporting of security incidents required improvement. The failure to appropriately monitor and report security incidents is usually a breach of an agency's own security policy. It may also affect or delay incidents being addressed, as recurring issues may take longer to identify and resolve.

3.17 Most agencies without robust security monitoring and reporting procedures were in the process of developing and implementing such procedures at the time of audit. The ANAO considers this activity should be finalised as a priority in order to mitigate potential risks in this area.

3.18 Overall, well designed, implemented, and maintained IT security management policies and procedures assist in ensuring agencies maintain the reliability and integrity of data, services, and systems. Most agencies had implemented effective controls for managing their IT security.

IT incident and problem management

3.19 IT systems incidents and problems will affect all agencies from time to time during the normal course of business operations. The efficient handling of these issues is essential for maintaining service delivery.

3.20 IT incidents are events that may interrupt or diminish the quality, accuracy or availability of an IT system. Incident management refers to the methods and procedures used to resolve such events. IT problems are multiple incidents that had a common source and problem management is the process of finding and resolving the underlying causes of related incidents.

3.21 Agencies commonly use a service desk²⁸ approach to establish centralised and structured processes for collecting, managing, and responding

²⁸ Also commonly referred to as an IT Helpdesk.

to incidents and problems.²⁹ Effective implementation of a service desk assists agencies to minimise adverse impacts to service delivery from IT incidents and problems.

3.22 The following were the key control categories for incident and problem management examined by the ANAO:

- incident management processes;
- problem management processes;
- service desk procedures
- use of configuration management tools;
- link to change management processes; and
- incident and problem analysis and reporting.

Observations

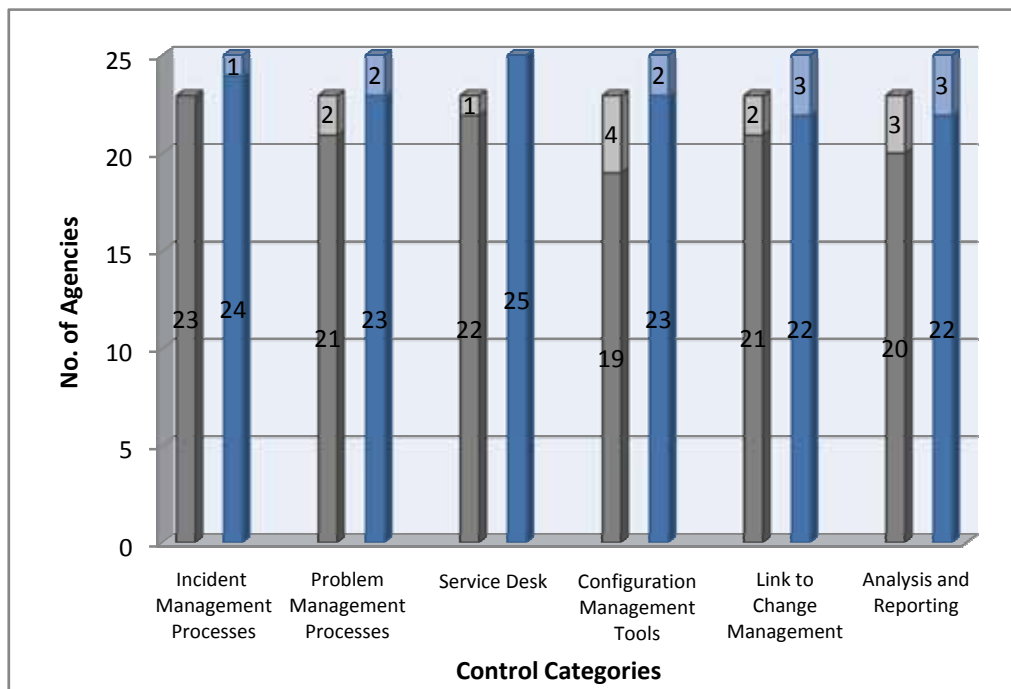
3.23 The aggregated results of our assessment of the control categories for incident and problem management, in the context of agencies' financial statements, are outlined in Figure 3.2 below:

²⁹ IT incidents and problems are generally daily events and are 'business-as-usual' or routine matters that every agency encounters and must manage.

Figure 3.2

Assessment of IT incident and problem management control categories

2008-09: ■ Effective ■ Needs Improvement
 2007-08: ■ Effective ■ Needs Improvement



3.24 The ANAO noted an improvement by agencies in their overall management of IT incidents and problems compared with previous years. The implementation of standard incident and problem management processes in most agencies assists in creating logical workflows, and the handling of incidents and problems in a consistent and repeatable manner. In addition, the use of a service desk as a central management point for IT incidents and problems is now well established in most agencies.

3.25 The adoption, maintenance, and support for configuration management tools had increased significantly since the 2007–08 audits. Only a small number of agencies did not have configuration management tools and supporting processes in place. By comparison, almost one fifth did not have these tools in 2007–08. The tools assist agencies to maintain the integrity of technology systems by storing information about system attributes at a central location using a common format.

3.26 One area that should remain a focus for agency improvement is linking incident and problem management procedures to change management processes. A clear link helps to ensure incidents and problems, once escalated, are not lost or mistakenly closed and resolution activities are appropriately defined, tested, and implemented.

IT change management

3.27 An IT change management process is a standardised approach for making changes to an IT environment. These include changes to all technology and communications components, including networks, hardware platforms, application software, and supporting process and procedure documentation. The aim of process standardisation is to allow changes to occur effectively in a controlled and timely manner, with a minimal number of incidents or problems occurring on release to the production environment.

3.28 Effective change management helps ensure that changes are appropriately planned, implemented, and evaluated and ultimately assist in enhancing agency service delivery. Such processes also help maintain the reliability and integrity of systems by mitigating the risk of incidents or problems.

3.29 The ANAO tested controls supporting the change management process in the following key categories:

- change management policy and governance structures;
- change logs and reporting
- release management procedures;
- change approval, prioritisation and tracking;
- emergency change procedures; and
- change backout procedures.

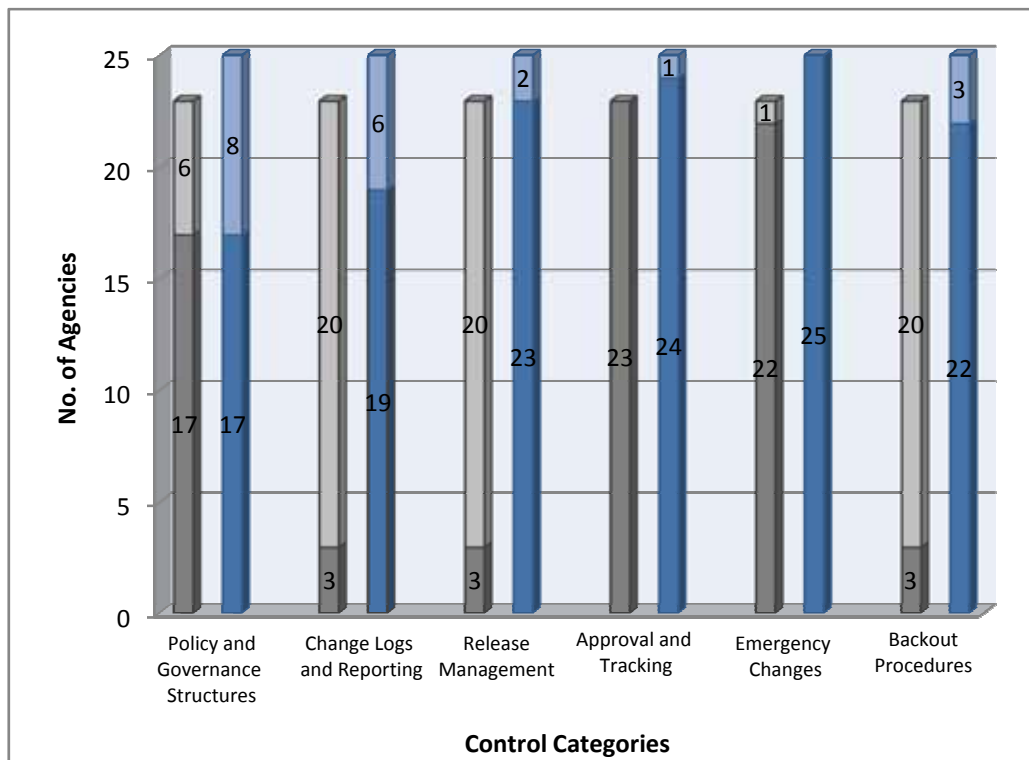
Observations

3.30 The findings from our testing of change management control categories that support authorised and tested changes within agencies, in the context of agencies' financial statements, are summarised in Figure 3.3 below:

Figure 3.3

Assessment of IT change management control categories

2008-09: ■ Effective ■ Needs Improvement
 2007-08: ■ Effective ■ Needs Improvement



3.31 Overall, most agencies had effective change management policy and governance structures. This is consistent with our assessment in 2007–08. Agencies also had well-documented change processes, with respective roles and responsibilities suitably defined, as well as evidence of appropriate levels of stakeholder involvement and management reviews. Establishment and maintenance of these procedures increases the consistency of the change management process, which in turn enhances the overall reliability of system changes.

3.32 Nevertheless, many agencies did not review on a regular basis their policies and procedures that govern the change management process. Due to the continually changing nature of the IT environment, the nature of the controls surrounding change management requires regular review to ensure

they remain current and applicable. This enhances the integrity of the overall process, reducing the risk that system changes will affect system availability.

3.33 Most agencies had improved specific aspects of their change management controls since the 2007–08 audits, including change logging and reporting, release management and backout procedures. Nevertheless, a number of agencies were still to fully implement effective control procedures in these areas to ensure changes are appropriately planned and implemented.

3.34 Overall, IT change management presents opportunities for several agencies to improve their related controls and reduce the risk of an adverse effect on the availability of the IT environment and, consequently, provision of accurate and timely financial information.

IT application controls

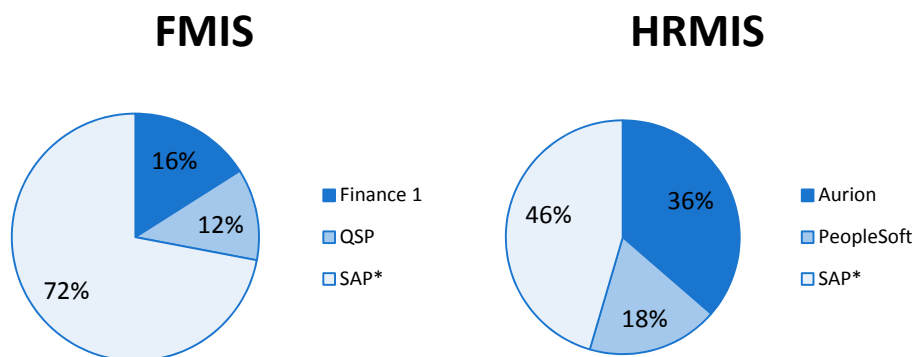
3.35 Two key financial reporting systems are utilised by Australian Government agencies in the preparation of financial information. These are the Financial Management Information System (FMIS) and the Human Resource Management Information System (HRMIS).

3.36 Due to their importance for financial reporting, the ANAO reviews, tests, and reports on key controls of FMIS and HRMIS systems across all agencies. While there is a range of different application systems used, a similar set of controls is required to help preserve the reliability and integrity of financial information.

3.37 Figure 3.4 below details the specific financial reporting applications systems used by the agencies covered by this report.

Figure 3.4

Summary of financial reporting application systems



**A Better Practice Guide SAP ECC 6.0 Security and Control will be published in June 2009.*

Financial management information systems

3.38 The FMIS is the IT system that tracks financial events and summarises financial information. It supports financial management decision-making, budget and financial planning, and the preparation of financial reports and statements.

3.39 The following FMIS control categories were reviewed as part of the 2008–09 financial statement audits:

- payment processing reconciliations;
- user access management;
- privileged user management;
- application business continuity procedures;
- maintenance of masterfile reference information;
- application administration and maintenance; and
- user support and training.

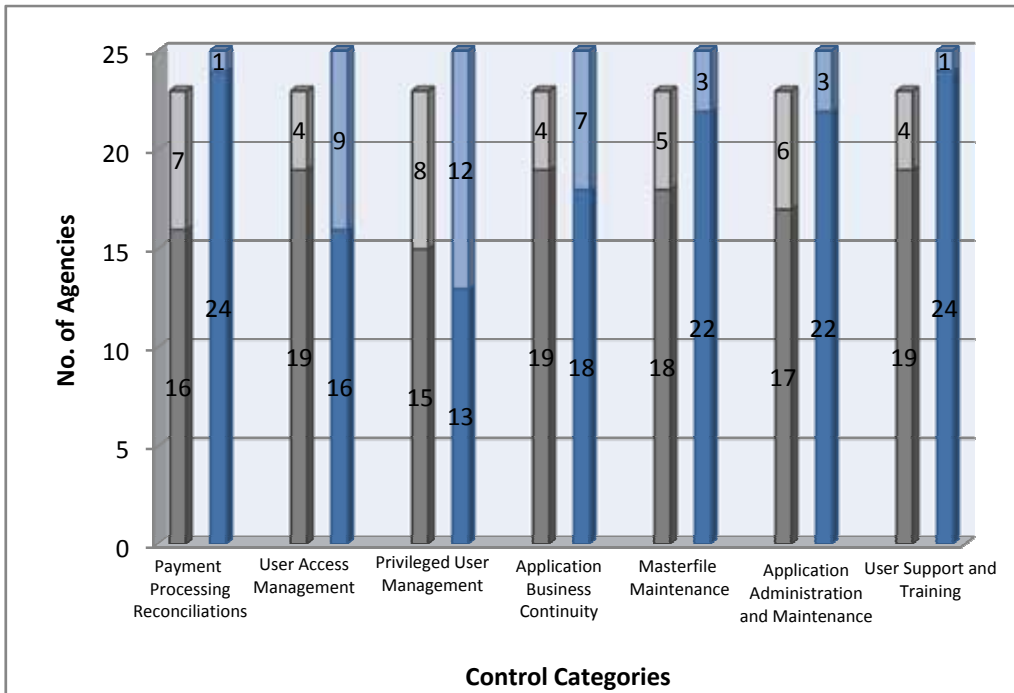
Observations

3.40 The ANAO assessment of key FMIS control categories that are integral to effective financial management and reporting, in the context of agencies' financial statements, is summarised in Figure 3.5 below:

Figure 3.5

Assessment of FMIS control categories

2008-09: ■ Effective ■ Needs Improvement
 2007-08: ■ Effective ■ Needs Improvement



3.41 Since the 2007–08 audits, agencies had shown considerable improvement in the management of several key FMIS controls including the reconciliation of payment processing files. In 2007–08, almost one third of agencies did not implement these key controls, whereas audit testing in 2008–09 demonstrated the controls to be effective in almost every agency.

3.42 However, the ANAO’s audit identified that FMIS user access controls were inadequate in many agencies. In particular, inadequate segregation of duties existed in over a third of agencies. When there is not adequate segregation, such as the ability to both enter and authorise a payment, it is possible for individuals to undertake actions that may undermine the integrity of financial systems and information. Agencies should give priority to establishing and maintaining effective segregation of duties as an important category of controls.

3.43 Inadequate logging of privileged user activities was identified in almost half of agencies. Privileged users, such as system administrators, typically had greater access to the FMIS than other staff, and hence had more potential to affect the integrity of financial information if such access was incorrectly used. The logging and monitoring of privileged users is an important control to prevent or detect inappropriate use of the greater access afforded to these users.

3.44 A lack of FMIS business continuity testing was also identified in over a quarter of agencies. Any failure in the FMIS during a business disruption event could have significant consequences for an agency's capacity to maintain the completeness and availability of its financial information. While these systems should be part of broader agency business continuity plans, the key nature of the FMIS means that its specific continuity plan should be subject to regular testing.

Human resource management information systems

3.45 The HRMIS is the IT system that facilitates strategic and operational decision-making for human resource management. The financial data that it provides is a major component of the financial reporting process.

3.46 The key categories of agencies' HRMIS controls reviewed as part of the audit coverage were:

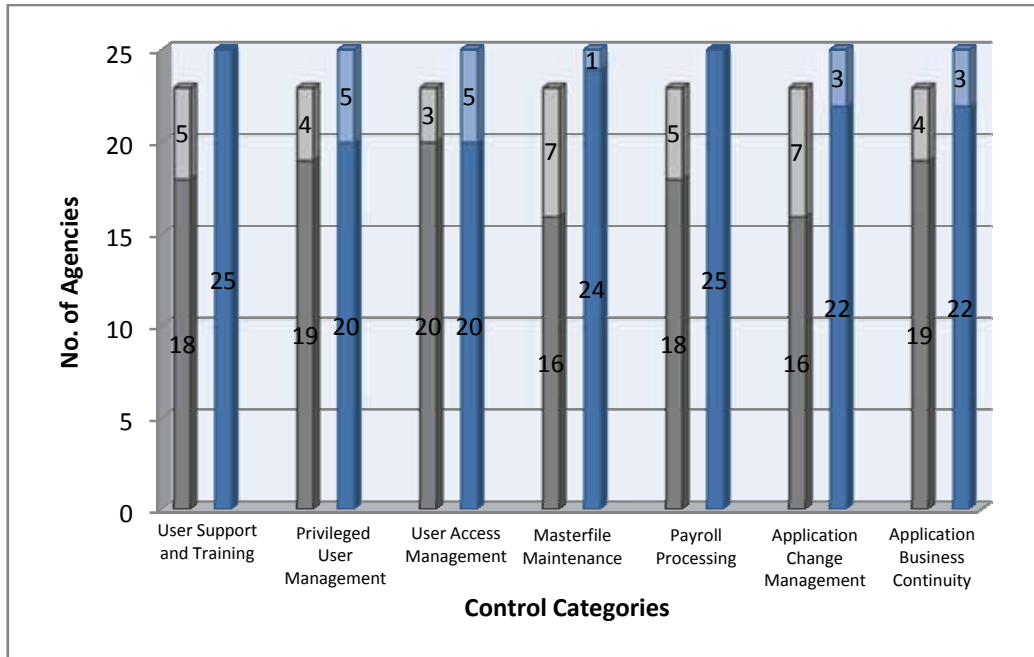
- user support and training;
- privileged user management;
- user access management;
- maintenance of masterfile reference information;
- payroll processing management;
- application change management; and
- application business continuity procedures.

Observations

3.47 The ANAO assessment of key HRMIS control categories that enhance the completeness and accuracy of HR financial information, in the context of agencies' financial statements, is outlined in the figure below.

Figure 3.6**Assessment of HRMIS control categories**

2008-09: ■ Effective ■ Needs Improvement
 2007-08: ■ Effective ■ Needs Improvement



3.48 Controls over agencies' HRMIS had shown some improvement since our 2007–08 audits. An example of this improvement is the increase in the provision of formal user training and support within agencies. The establishment of ongoing training and support for HRMIS users assists in ensuring correct system use, and facilitates the sound maintenance of financial records. In 2007–08, over one fifth of agencies did not demonstrate the effective implementation of training and support, compared with 2008–09 when all agencies had established effective controls in this area.

3.49 Similar to the situation for FMIS's, one fifth of agencies were not appropriately managing HRMIS system administrators and other users who had special privileges. This creates a level of risk to the integrity of financial information as such users typically had full access to all HRMIS financial transactions and information.

3.50 The ANAO also observed that many agencies were failing to log the actions of users with authorised HRMIS access. This is an important category

of controls, as they provide a means to identify users that make changes to human resources data. The absence of a log creates a risk to the reliability and integrity of agencies' HR-related financial information.

Conclusion

3.51 The range of IT controls discussed in this chapter underpins the secure and cost-effective provision of Australian Government services. They also provide for the reliability and integrity of financial information. A failure by agencies to both manage and implement IT controls can lead to increased risks that information, including financial information, is inaccurate, incomplete, or inappropriately disclosed.

3.52 The ANAO's focus is on aspects of agencies' IT control environments that could result in financial statements being materially misstated. Based on our work, there has been a number of improvements across the IT control environments of many agencies since 2007–08. Most noticeable has been the implementation of more effective IT security, incident, and problem management procedures. These improvements have enhanced the overall level of security and integrity of key financial systems. However, the design and operation of agencies' FMIS and HRMIS controls did not show the same level of improvement. A common weakness identified across a number of agencies is the management of special or privileged users, including the failure to log and monitor the activities of these users.

3.53 While systems generally had effective security and configuration controls, the failure to effectively manage special or privileged users can undermine the integrity of these systems.

3.54 The ANAO also observed that many agencies did not review their change management procedures on a regular basis. This can reduce the effectiveness of these processes to manage changes in a controlled and timely manner. As an agency's technical or business environment may have changed since the last review of agencies' change management procedures, these procedures may have some gaps or omissions. This increases the risk of errors or problems arising that may affect service delivery.

3.55 The ongoing effectiveness of controls is an important element in maintaining the integrity of agencies' financial information. In future audits, the ANAO will continue to monitor the status of agencies' IT control environments and, in particular, focus attention on FMIS and HRMIS security,

and change management procedures. In addition, the ANAO will assess the impact on agencies' IT control environments of major changes to business processes.

4. Interim Audit Results by Agency

This chapter summarises the results of the interim phase of the 2008–09 financial statement audits of the 26 agencies, grouped by portfolio, covered by this report.

Introduction

4.1 This Chapter summarises the results of the ANAO 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 2009. These agencies comprise the portfolio departments and other entities that manage the majority of the GGS financial activities.

4.2 The ANAO's audits of Australian Government agencies are designed to be performed on an ongoing basis to allow agencies to submit audit cleared financial information to Finance³⁰ for the purposes of informing government of the financial outcome for the 2008–09 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.

4.3 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, expected to be tabled in December 2009.

4.4 The summary of each agency's interim audit results comprises:

- an introductory commentary regarding the agency's business operations;
- estimated actual key financial figures and the estimated average staffing level for the year ended 30 June 2009;³¹
- an overview of the environment including comments on governance arrangements relevant to the agency's financial management

³⁰ The deadlines for the submission of audit cleared information are 15 August for material agencies and 31 August for non-material agencies.

³¹ These figures are sourced from each agency's 2009–10 Portfolio Budget Statements. These figures include the Net Cost of Services (NCS) for each agency. Commencing from 2009-2010, agency Income Statements are required to be provided on a NCS basis. The NCS is calculated as Total Expenses less Total Own-Source (or Other) Income. This approach recognises that the primary role of agencies is the delivery of services to the public, rather than the generation of a surplus.

responsibilities and a summary of the agencies financial reporting capability;

- identification of the agency's key financial reporting risks;
- the audit findings relating to Category A and B issues identified; and
- an overall conclusion.

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

4.6 Key audit related business and financial statement risks were identified and communicated to each agency as part of the planning phase of each audit. These risks represent the ANAO's assessment of the key factors that give rise to the potential for material misstatement in an agency's financial statements. 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.

4.7 Issues arising from audit activity are rated in accordance with the seriousness of the particular matter. The rating that is included in ANAO reporting to agencies also reflects the priority the agency needs to give to remedial action. The ratings are defined as follows:

- Category A: those matters which pose significant business or financial risk, including financial reporting risk, to the client and should be addressed as a matter of urgency. This assessment has taken account of both the likelihood and consequences of the risk eventuating;
- Category B: those matters which pose moderate business or financial risk, including financial reporting risk, to the client or matters referred to management in the past, which have not been addressed satisfactorily. These would include matters where the consequences of the control weakness might be significant, however there is a low likelihood of the consequences eventuating; and
- Category C: those matters which are procedural in nature or minor administrative failings. These could include minor accounting issues or relatively isolated control breakdowns which need to be brought to the attention of management.

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

4.9 The status of prior year Category A and B issues as well as the 2008–09 A and B findings raised by the ANAO are provided in a summary table for each agency.

4.10 The following table provides an overview of the Category A and B issues relating to each agency resulting from the 2007–08 and 2008–09 interim audits.

Table 4.1**Significant findings of agencies grouped by portfolio covered by this report**

Entity	2008–09 Rating		2007–08 Rating	
	A	B	A	B
Department of Agriculture, Fisheries and Forestry	0	1	0	0
Attorney–General’s Department	0	3	0	1
Australian Customs and Border Protection Service	0	3	0	2
Department of Broadband, Communications and the Digital Economy	0	0	0	1
Department of Defence	2	25	7	40
Defence Materiel Organisation	0	12	1	12
Department of Veterans’ Affairs	0	1	0	1
Department of Education, Employment and Workplace Relations	0	1	0	0
Department of the Environment, Water, Heritage and the Arts	0	0	0	0
Department of Families, Housing, Community Services and Indigenous Affairs	0	0	0	1
Department of Finance and Deregulation	0	2	0	0
The Board of Guardians and the Future Fund Management Agency	0	0	0	0
Department of Foreign Affairs and Trade	0	5	0	0
Department of Health and Ageing	0	0	0	4
Department of Human Services	0	0	0	0
Centrelink	0	1	0	3
Medicare	0	0	0	2
Department of Immigration and Citizenship	0	3	1	11
Department of Infrastructure, Transport, Regional Development and Local Government	0	0	0	1
Department of Innovation, Industry, Science and Research	0	0	0	0
Department of the Prime Minister and Cabinet	0	0	0	1
Department of Climate Change	0	0	0	0
Department of Resources, Energy and Tourism	0	0	0	0
Department of the Treasury	0	1	0	0
Australian Office of Financial Management	0	0	0	0
Australian Taxation Office	1	7	1	4
Total	3	65	10	84

Source: ANAO

Agriculture, Fisheries and Forestry Portfolio

Department of Agriculture, Fisheries and Forestry

Business operations

4.1 The Department of Agriculture, Fisheries and Forestry (DAFF) is the primary policy formulation and advisory body to the Government on Australian agriculture, fisheries, forestry and food issues.

4.2 DAFF's role is to contribute to more sustainable, competitive and profitable Australian agricultural, fisheries, forestry and food industries.

4.3 A key aspect of DAFF's responsibility is working with rural and regional communities, industries and state and territory governments.

4.4 DAFF is responsible for enhancing the natural resource base on which portfolio industries rely and for delivering scientific advice and economic research, policy advice, programs, quarantine and export services to help industries deal with the challenges they face. DAFF's responsibilities span Australia's entire food chain, from producer to processor to the consumer.

4.5 DAFF's objective in 2008–09 and beyond is to implement the Government's priorities by better positioning agriculture, fishing, forestry and food related industries to respond to the main threats and opportunities ahead. In line with the government's broader priorities, DAFF's key actions focus on responding to climate change, increasing productivity, improving its quarantine and biosecurity systems, and maintaining and extending international market access for Australian agricultural produce. Collectively these actions contribute to the following outcome:

Australian agricultural, fisheries, food and forestry industries that are based on sustainable management of and access to natural resources, are more competitive self-reliant and innovative, have increased access to markets, are protected from diseases and are underpinned by scientific advice and economic research.

4.6 The department is progressively implementing many of the recommendations of the Equine Influenza Commission of Inquiry (Callinan

Inquiry) and the Quarantine and Biosecurity Review (Beale Review). This has involved a significant organisational restructure as a precursor to the establishment of a separate quarantine and biosecurity agency.

4.7 DAFF's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	354	
Appropriation revenue	344	
Administered income		538
Administered expense		1 751
Total assets	249	251
Total liabilities	231	121

DAFF's estimated average staffing level for 2008–09 is 4485.

Understanding the environment

4.8 As part of DAFF's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DAFF's corporate governance arrangements and financial reporting framework.

Corporate governance

4.9 The key elements of DAFF's corporate governance that contribute positively to the financial management regime of the department include:

- an executive management team that meets monthly and provides leadership to DAFF divisions on administrative and operational aspects;
- a corporate committee framework including an audit committee. The audit committee meets at least bi-monthly and focuses on risk management, the control environment, internal and external reporting, and audit coverage;
- a finance sub-committee of the audit committee that meets at least bi-monthly and oversees the preparation of the annual financial statements;

- an internal audit function that has a planned risk based coverage of DAFF's activities including the Australian Quarantine Inspection Service;
- a corporate governance and policy division that is responsible for the monitoring and management of risks; and
- an up-to-date fraud control plan. The fraud control plan provides a high level overview of systems to prevent, control and monitor fraud.

Financial reporting framework

4.10 DAFF reports comprehensively on its financial operations through full accrual monthly management financial reports to the executive management team and to the Department of Finance and Deregulation within ten days of the end of each month.

4.11 The financial reports to the executive management team are supplemented with non-financial information. More substantial reports are prepared at quarterly intervals. The non-financial information is primarily focused on programs and budgeted outcomes. Key Performance Indicators (KPIs) are monitored throughout the year at a divisional level and are reported bi-annually at a corporate level. The KPIs are reviewed when each division prepares its annual business plan.

Identifying financial reporting risks

4.12 The ANAO's understanding of DAFF and its environment enables the risks of material misstatement of the financial statement to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.13 The ANAO has assessed the risk of material misstatement in the 2008–09 DAFF financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the large number of grant programs administered by the department, which increases the risk and the value of inappropriate payments being made, and the potential for misstatement of liabilities and commitments for grants and industry rebates;
- the reliance on Centrelink's systems and processes to deliver personal benefits payments made on behalf of DAFF, estimated at approximately \$560 million in 2008–09;

- risks to the accuracy and completeness of information transferred from subsidiary business systems into the FMIS and the performance and adequacy of reconciliations between business systems and the FMIS; and
- financial compliance risks arising from DAFF's decentralised divisions and responsibilities.

Audit results

4.14 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
Total	0	0	0	0	0	1	1

4.15 The 2008–09 audit highlighted the following issue that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matter—Category B

Developer access to IT production environment

4.16 In reviewing user access to the AQIS Import Management System (AIMS), the ANAO found that several developers from the AQIS Software Development Team had access to the AIMS production environment. The ANAO also observed that the access granted to these developers enabled them to change data elements within the Sybase Database (which, for example, contains information related to invoices raised in AIMS) and modify application program code.

4.17 Weaknesses in user access controls or change management procedures increase the risk that unauthorised system changes are migrated into production and could compromise the confidentiality, integrity and availability of processed data and consequential effects on the integrity of the

Source Code Library. This can put at risk the reliability of financial data in DAFF's FMIS and have a flow on impact on the year end financial statements.

Conclusion

4.18 The ANAO found that, with the exception of the finding noted above, DAFF's key internal controls were operating satisfactorily to provide reasonable assurance that the department will produce financial statements free of material misstatement. DAFF has responded positively to the ANAO's finding and associated recommendations and has indicated that access arrangements will be tightened.

Attorney–General’s Portfolio

Attorney–General’s Department

Business operations

4.19 The Attorney–General’s Department (AGD) is the central policy and coordinating agency of the Attorney–General’s Portfolio. AGD provides essential support to the Government in the maintenance and improvement of Australia’s system of law, justice, national security and emergency management systems.

4.20 AGD provides legislative policy and advice and other services in relation to constitutional policy, legislative drafting, international law, indigenous law and justice and film and literature classification. AGD is responsible for coordination of national security and management of Emergency Management Australia. The department also oversees and manages the government’s responsibilities for non-self-governing and external territories, and interests in self-governing territories. This covers the administration of the Territories of Ashmore and Cartier Islands, Christmas Island, the Cocos (Keeling) Islands, the Coral Sea Islands and Jervis Bay; and management of national interests in the ACT, the Northern Territory and Norfolk Island.

4.21 AGD’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	234	
Appropriation revenue	234	
Administered income		41
Administered expense		882
Total assets	240	837
Total liabilities	65	713

AGD’s estimated average staffing level for 2008–09 is 1479.

Understanding the environment

4.22 As part of AGD's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are AGD's corporate governance arrangements and financial reporting framework.

Corporate governance

4.23 The key elements of AGD's corporate governance that contribute positively to the financial management regime of the department include:

- an executive management group that addresses strategic issues, monitors AGD's financial performance, and oversees the operational performance of divisions;
- an audit committee that meets at least quarterly and focuses attention on internal controls, management of risks, review of financial reports, control of public monies and regulatory compliance;
- an internal audit function that has a planned risk based audit coverage of AGD's activities; and
- a fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines.

Financial reporting framework

4.24 AGD has developed a financial reporting framework that includes monthly reports on departmental and administered revenue and expenses. The reports include explanations for variances from budgeted or expected outcomes and forecasts and provide additional details on specific areas of interest to the executive.

Identifying financial reporting risks

4.25 The ANAO's understanding of AGD and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.26 The ANAO has assessed the risk of material misstatement in the 2008–09 AGD financial statements as moderate. The major factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- risks to the accuracy and completeness of grants that are subject to a decentralised approval and review processes;
- the estimation, through an actuarial process, of judges' pension liabilities given the materiality of the amount and the recent financial market volatility;
- risks associated with the implementation of internal controls and the accurate reporting of payments relating to the new AusCheck program;
- risks associated with the development and implementation of the Personal Properties Security Register;
- risks relating to the determination of an accurate valuation for the administered investment in Law Courts Limited, which is currently undertaking an extensive capital investment program;
- risks associated with the reporting and recording of the building fit out costs relating to its new Canberra headquarters;
- the on-going integration of the Territories function transferred to the department as part of the Machinery of Government changes in December 2007; and
- instability of financial indices resulting from the global financial crisis and the impact this may have on key financial statement items such as employee provisions and concessional loans.

Audit results

4.27 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	1	1	0	2	3
Total	1	(1)	1	1	0	2	3

4.28 The 2008–09 audit highlighted the following issues, categorised as moderate, that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matters—Category B

Assets Under Construction

4.29 At the time of ANAO’s interim testing, AGD was managing numerous capital projects totalling \$30m. These projects included the fitout of new office accommodation, and internally developed systems for both AusCheck and the Personal Properties Security Register. Costs associated with capital projects are recorded as ‘assets under construction’ (AUC) and capitalised on completion of projects. The ANAO’s review of AGD’s assets under construction balances identified a number of issues including delays in capitalising the cost of completed projects and a lack of formal procedures to regularly monitor and validate the accuracy of recorded AUC balances. AGD has indicated that the department will review all AUC balances prior to year end and implement strengthened procedures including regular review and monitoring of AUC balances.

IT Security

4.30 The ANAO conducted a IT security review of systems used in the preparation of AGD’s financial statements. The ANAO identified several weaknesses in access management practices relating to AGD’s HRMIS. These include inadequate management of inactive and terminated user accounts, the existence of generic accounts with high level access that had not been deactivated, log on security weaknesses, access authorisation/approval weaknesses, and a lack of review of security logs. In addition, security accreditation processes had not commenced, and there was no threat risk assessment, system security plan, or standard operating procedures in place.

Valuation of Law Courts Limited

4.31 During the final phase of the 2007–08 audit, the ANAO identified a moderate risk issue in relation to the maintenance of adequate accounts and records to support the decisions underpinning the valuation of the Law Courts Limited administered investment. At the completion of the 2007–08 audit AGD had commenced action to address this issue. These actions are continuing and are expected to be completed prior to the preparation of the 2008–09 financial statements. The ANAO will review this issue as part of our 2008–09 final audit.

Conclusion

4.32 Based on the audit work performed to date, the majority of AGD’s key internal controls were operating satisfactorily to provide reasonable assurance that the department will be able to produce financial statements free of material misstatement. AGD has responded positively to the ANAO’s finding and associated recommendations.

Australian Customs and Border Protection Service

Business operations

4.33 On 4 December 2008, the Government announced that the Australian Customs Service would be renamed the Australian Customs and Border Protection Service (Customs and Border Protection).

4.34 Customs and Border Protection is responsible for providing the nation with effective border management to facilitate the legitimate movement of goods and people across the Australian border while protecting the community and maintaining appropriate compliance with the laws. It also collects border-related revenue and administers trade measures and certain government industry schemes. Customs and Border Protection also assesses and collects, where appropriate, Goods and Services Tax on imported goods, Wine Equalisation Tax and Luxury Car Tax. The Tourist Refund Scheme is also managed by Customs and Border Protection on behalf of the Australian Taxation Office.

4.35 Customs and Border Protection also has responsibility for jointly co-ordinating with the Department of Defence, use of available resources to address maritime security requirements through the Border Protection Command.

4.36 In 2008–09 Customs and Border Protection received additional funding in areas of port security and border protection in Australia’s northern waters.

4.37 Customs and Border Protection’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	1 024	
Appropriation revenue	1 009	
Administered income		7 087
Administered expenses		3
Total assets	640	135
Total liabilities	246	9

Customs and Border Protection’s estimated average staffing level for 2008–09 is 5720.

Understanding the environment

4.38 As part of Customs and Border Protection’s financial statement audit, the ANAO gains an understanding of the agency and its environment, including internal controls. Two important factors considered are Customs and Border Protection’s corporate governance arrangements and its financial reporting framework.

Corporate governance

4.39 The ANAO’s audit approach considers Customs and Border Protection’s corporate governance structure. The key elements of Customs and Boarder Protection’s corporate governance that contribute positively to the financial management regime of the agency include:

- an audit committee, including two independent members, that meets at least quarterly and focuses on internal and risk management issues;
- an internal audit function that has a planned risk based audit coverage of Customs and Border Protection’s activities, including IT system management;
- a monthly Executive meeting to evaluate performance, in addition to a bi-annual meeting of senior executives from central and regional offices to discuss strategic management issues and future directions;

- a strategic outlook to the year 2015. Major processes and risks are identified through annual and corporate operation plans which flow from the strategic outlook;
- a risk management policy that documents how risk assessments are developed and monitored; and
- the Customs and Border Protection Practice Statement Program which is a framework used to define and implement its national policies.

4.40 Customs and Border Protection continues to develop its risk management framework including fraud policies and plans, to assist in monitoring external client compliance with regulations and to detect fraud in relation to revenue collection.

Financial reporting framework

4.41 Customs and Border Protection prepares a monthly management report for the executive that compares year-to-date actuals to budgets, identifies and analyses variances, and provides details of the year's full budget. Reporting of trends and future implications is done through narrative variance analysis. Financial reports, based on the monthly management reports, are also provided to the audit committee.

Identifying financial reporting risks

4.42 The ANAO's understanding of Customs and Border Protection and its environment enables the risks of material misstatement to the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed to form an opinion on the financial statements.

4.43 The ANAO has assessed the risk of material misstatement in the 2008–09 Customs and Border Protection's financial statements as moderate. This has been reduced from the assessment of high risk of material misstatement in place in previous years. In recent years there has been significant improvement in the general IT environment surrounding Customs and Border Protection's major IT systems. The key risks identified and assessed and on which the financial statement audit is particularly focused include:

- risks associated with significant revenue collection in a self assessment environment;
- risks associated with the use of large and complex IT systems; and

- risks associated with the current global and domestic economies.

Audit results

4.44 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	2	0	0	2	0	1	3
Total	2	0	0	2	0	1	3

4.45 The 2008–09 audit identified the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matters—Category B

New moderate audit issue

IT Change Management

4.46 IT change management processes should include controls to ensure that only approved and tested changes are made to IT systems. The ANAO examined a sample of changes to Customs and Border Protection’s IT systems. A significant number of the changes made were not supported by appropriate documentation. Incomplete documentation included a lack of implementation plans, acceptance checklists, test plans and change approvals. Control weaknesses in change management processes increase the risk that IT changes will be migrated to the production environment without testing and in an uncontrolled manner. Customs and Border Protection has accepted the audit recommendation and is reviewing its IT change management controls to ensure only approved and tested changes are migrated into production.

Prior year audit issues

IT Security Controls

4.47 Customs and Border Protection has an ICT security policy which includes policies to prevent unauthorised access to its IT systems. The ANAO

reviews access controls over Customs and Border Protection's local area network. The local area network environment provides authentication services to the majority of IT systems, including key financial information systems. The 2007–08 audit identified instances where access controls were inconsistent with Customs and Border Protection's ICT security policy. The 2008–09 interim audit identified that inconsistencies continued to exist. Weaknesses included insufficient complexity of passwords, lack of monitoring of privileged users and instances where there was inappropriate approval of new users. These weaknesses increase the risk of unauthorised access by users that could adversely affect the integrity of Customs and Border Protection's financial information. Customs and Border Protection has accepted the audit recommendation and is reviewing its ICT security practices to ensure they are consistent with its policies.

Asset Management

4.48 Customs and Border Protection manages physical assets, including infrastructure, plant and equipment valued at over \$170 million. The location of these assets should be recorded in the assets register as a control to assist in ensuring that the assets exist and to assist in their management. The 2007–08 audit identified that, for a number of assets, the location recorded in the asset register was not correct. In 2008–09, weaknesses were again noted in the recording of the location of assets. Customs and Border Protection is in the process of completing an extensive stocktake program designed to ensure the accurate recording of the location of its assets which, when completed, should remedy this weakness.

Conclusion

4.49 The ANAO found that, with the exception of the abovementioned audit findings, Customs and Border Protection's key controls relevant to the financial statements were operating satisfactorily to provide reasonable assurance that the agency will produce financial statements free of material misstatement. Customs and Border Protection has

responded positively to the ANAO's findings and the associated recommendations and is working to address the issues identified by the ANAO.

Broadband, Communications, and the Digital Economy Portfolio

Department of Broadband, Communications and the Digital Economy

Business operations

4.50 The Department of Broadband, Communications and the Digital Economy (DBCDE) works with industry, consumer groups and regulatory authorities to develop a vibrant, sustainable and internationally competitive broadband, broadcasting and communications sector, which promotes the digital economy for the benefit of all Australians. The department provides strategic advice and support to the Australian Government on a wide range of significant and rapidly changing policy areas including:

- broadband;
- cyber-safety;
- post and telecommunications;
- radio frequency spectrum management;
- broadcasting;
- digital television switchover; and
- the digital economy.

4.51 DBCDE's estimated key financial figures for the year ending 30 June 2009 are:

Key Financial Figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	117	
Appropriation revenue	117	
Administered income		515
Administered expense		1 241
Total assets	97	3 993
Total liabilities	29	12

DBCDE's estimated average staffing level for 2008–09 is 635.

4.52 Recent government announcements have been made on the formation of a company to build and operate a \$43 billion wholesale open-access National Broadband Network (NBN). Initially, it is expected that this company will be wholly Government owned. The Government has foreshadowed that the company will be subject to a legislative regime that will cover competition and ownership arrangements. Details of governance and ownership restrictions will be determined following consideration of an implementation study, with the intention of encouraging private sector participation in the longer term.

Understanding the environment

4.53 As part of DBCDE's financial statement audit, the ANAO gains an understanding of the agency and its environment and internal control. Two of the important factors considered are DBCDE's corporate governance arrangements and financial reporting framework.

Corporate governance

4.54 The key elements of DBCDE's corporate governance that contribute positively to the financial management regime of the department include:

- an executive management group 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 departmental policies and procedures;
- an audit committee that meets at least quarterly and focuses attention on internal controls, internal audit activity, management of risks, review of financial reports, control of public monies, fraud control, and regulatory compliance;
- an internal audit function that has a planned risk-based audit coverage of DBCDE's activities; and
- fraud control and risk management plans that are regularly monitored and reviewed.

Financial reporting framework

4.55 DBCDE has a financial reporting framework that involves key financial and non-financial performance indicators being tracked and measured at the divisional level and reported to senior management for decision making. This

includes the monthly preparation and distribution of divisional financial management reports which include administered and departmental revenues, expenses, assets, and liabilities. The reports incorporate explanations for variances between actual, budgeted and expected outcomes on both an accrual and cash basis. They also include additional details on specific areas of interest to the executive.

Identifying financial reporting risks

4.56 The ANAO’s understanding of DBCDE and its environment have been considered when determining the risk of material misstatement in the financial statements and in the design of appropriate audit procedures.

4.57 The risk of material misstatement in DBCDE’s 2008–09 financial statements has been assessed as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- program management, given the diverse nature and significance of the rollout of the broadband program being managed by the department; and
- grant and subsidies processing and management, given the complexity of related eligibility criteria, legislation, review processes and the impact of economic conditions on the recipients of grants and subsidies and related delivery agents.

Audit results

4.58 The following table provides a summary of the status of prior year issues as well as audit issues raised as a result of the 2008–09 interim audit.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	1	1	(1)	0	0
Total	1	(1)	1	1	(1)	0	0

4.59 There were no significant or moderate risk audit issues identified during the 2008–09 interim audit. Audit testing confirmed that the department

has addressed the Category B issue from the 2007–08 final audit, relating to weaknesses in the reporting of expenses and accruals for broadband subsidy programs.

Conclusion

4.60 Based on audit work performed to date, DBCDE's key internal controls were operating satisfactorily to provide reasonable assurance that the department will be able to produce financial statements free of material misstatement.

Defence Portfolio

Department of Defence

Business operations

4.61 For 2008–09, the Department of Defence (Defence) was responsible for delivering three outcomes:

- Australia’s national interests are protected and advanced through the provision of military capabilities and the promotion of security and stability;
- Military operations and other tasks directed by Government to achieve the desired results; and
- Defence’s support to the Australian community and civilian authorities to achieve the desired results.

4.62 Defence’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	20 268	
Appropriation revenue	20 268	
Administered income		844
Administered expense		3 358
Total assets	61 214	1 207
Total liabilities	4 557	39 598

4.63 Defence’s estimated average staffing level for 2008–09 is 90 231 comprising permanent forces of 55 118, total reserves of 20 026, total civilian staff of 14 534 and professional service providers of 553.

Understanding the environment

4.64 As part of Defence’s financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two important factors considered are Defence’s corporate governance arrangements and financial reporting framework.

Corporate governance

4.65 Defence has a number of committees responsible for matters relating to corporate governance including, finance, people, strategy, resources, operational delivery and capabilities. Only details of those committees considered most relevant to the financial statement audit are detailed below.

4.66 The Defence Committee, chaired by the Secretary, is the pre-eminent committee within Defence supporting the Secretary and the Chief of the Defence Force (CDF) in meeting their joint obligations under the Ministerial Directive. The Defence Committee provides senior management advice to the Secretary and the CDF on strategic management and governance issues, and monitors the overall performance of the Defence Organisation. The Chiefs of Service Committee (COSC), chaired by the CDF, provides military advice to assist CDF to discharge his responsibilities in command of the Defence Force and as principal military adviser to the Government.

4.67 The Defence Audit Committee (DAC) is a sub-committee of the Defence Committee. The Chair of the DAC is responsible and accountable to the Secretary for the functions of the DAC. The DAC is responsible for reviewing the preparation and audit of the Defence financial statements and providing advice to the Secretary on the adequacy of these statements and the adequacy of accounting policies, procedures and systems. The DAC is also responsible for approving Defence's annual audit plans and monitoring Defence's enterprise risk management.

4.68 The Financial Management and Controls Committee (FMCC) (formerly the Financial Statements Project Board) is responsible for overseeing and monitoring the inventory remediation project and the financial controls environment, the remediation of audit findings; and the risks to financial statements. The FMCC includes the Chief Finance Officer as Chair, the Chief Finance Officer of Defence Materiel Organisation, and representatives from the three Services and key Defence groups.

4.69 Another key element of Defence's corporate governance arrangements is its internal audit function, known as the Management Audit Branch (MAB). MAB performs a range of internal audits across Defence and the DMO (a major provider of goods and services to Defence) and reports its findings to the DAC and the Defence Executive.

4.70 Work continues on the finalisation of the Defence enterprise risk management plan, risk profile, and a risk tolerance statement. With the release

of the White Paper and its emphasis on organisational reform, there will be a renewed focus on these activities.

The financial management framework

4.71 Defence's financial management framework provides a formalised structure to manage Defence's financial risks by:

- documenting key financial management processes, financial management risks and the controls to mitigate these risks;
- assigning accountability for the effective operation of controls;
- implementing a comprehensive training regime to support financial management; and
- establishing a single system of monitoring, designed to ensure that the controls framework retains its relevance and integrity.

4.72 This framework includes the identification and documentation of over 527 key financial process controls designed to mitigate 379 financial risks. This includes 98 risks and 118 controls relating to General Stores Inventory and Repairable Items, which are separately managed by the DMO.

4.73 The challenge for Defence has been ensuring controls are working effectively. To respond to this situation, Defence has in place arrangements to manage and monitor the operation of these controls through three mechanisms:

- designated control owners perform monthly self-assessment tests (SATs) to confirm the status of the operation of a sample of controls;
- Defence's CFO Group monitors the performance of the SATs; and
- Defence's CFO Group perform monthly independent testing of the operation of controls by Defence's CFO Group in order to validate and assess the overall design and operating effectiveness of controls.

4.74 In 2008–09, Defence advised that the department is performing over 1 300 control tests in five testing rounds across all Defence groups, and locations across Australia. This is an increase in the number of controls tested in 2007–08 at which time 95% of controls tested demonstrated that the intent of the control was achieved.

4.75 In 2007–08, the ANAO recommended improvements be made to the information technology aspects of the financial controls framework to address

a lack of comprehensiveness and the generic nature of the IT controls within the framework.

4.76 The ANAO's review of the financial controls framework, will be completed during the final phase of the 2008–09 audit, with the view of drawing reliance on the management assurance activities to support audit work in future years.

Defence Reform

4.77 The Defence White Paper was released on the 2 May 2009, and will form the foundation for Defence capabilities, business and budget priorities through to 2030.

4.78 Defence is about to embark on a challenging program of strategic and organisational reform which will encompass the broad themes of improved accountability; improved planning; and enhanced productivity.

4.79 The Strategic Reform Program will be delivered from mid-2009 stretching across the first half of the next decade. Defence expects to deliver significant ongoing savings through a fundamental recasting of Defence management practices.

Identifying financial reporting risks

4.80 The ANAO's understanding of Defence and its environment has enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.81 The ANAO has assessed the risk of material misstatement in the 2008–09 Defence financial statements as high. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include an analysis of business processes, the control environment, the bureau service arrangements between Defence and DMO, prior years audit issues including weaknesses relating to key inventory and asset systems, financial management systems and human resource systems.

Impact of the Global Financial Crisis

4.82 A number of areas in Defence's financial statements are impacted by the Global Financial Crisis (GFC). Defence has undertaken an analysis of the impact of the GFC and considers it will have an impact on the carrying value of Defence assets, long service leave liabilities, superannuation liabilities, and

the cost of foreign exchange purchases of equipment and other goods and services.

4.83 The government bond rate is used to discount long service leave and superannuation liabilities to their present value. The significant decrease in the government bond rate will result in these liabilities increasing in 2008–09 and a related increase in associated expenses.

4.84 The drop in the Australian dollar over the past year will result in an increase in the cost of foreign exchange purchases of equipment and other goods and services. However, Defence is funded on a no-win no-loss basis by the Government and will receive additional funding to cover these losses.

4.85 Defence is undertaking a review that will outline the financial reporting response to the GFC and actions required to adjust asset and liability balances. The ANAO audit program will take into account the results of this review during the 2008–09 final audit.

Audit results

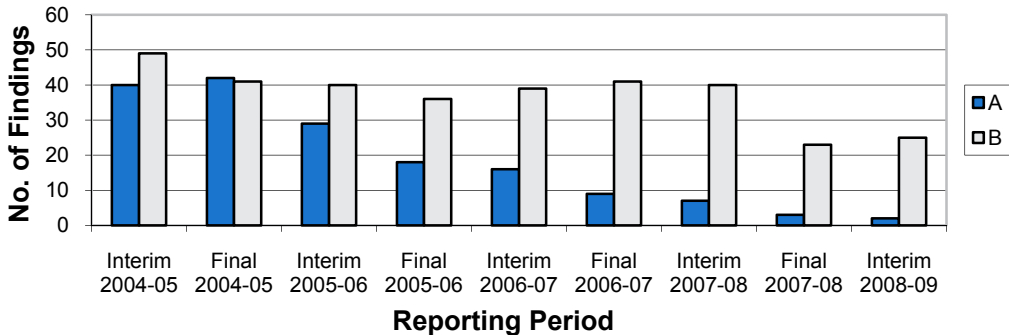
4.86 The following table provides a summary of the status of prior year issues as well as 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	3	(1)	0	2
B	23	(3)	5	25
Total	26	(4)	5	27

4.87 The table below presents an analysis of significant and moderate findings reported in the financial statement audit of Defence over the past five years. The table illustrates the downward trend in the number and severity of findings since 2004–05 as a result of Defence’s remediation program and management focus on the financial controls framework. To ensure the successful remediation of the remaining findings and consolidation of Defence’s successes, continued focus on previously remediated issues with respect of the internal control environment is needed.

Reporting of Defence Findings



4.88 The interim phase of the 2008–09 audit identified that Defence had resolved one significant and three moderate risk issues.

Financial Management Framework

4.89 As previously mentioned, the Defence financial management framework encompasses ongoing monitoring of the controls and reporting processes in place over financial transactions and balances within Defence. At the completion of the 2007–08 audit, the ANAO had reported two moderate issues in relation to the framework, relating to:

- a need for greater oversight and management of the bureau arrangements between DMO and Defence; and
- deficiencies in quality assurance and reporting processes over financial transactions.

4.90 The issue in relation to the management and oversight of arrangements between DMO and Defence remains outstanding. The ANAO is finalising its review in this area, and the results will be reported during the final audit phase.

4.91 Improvements were noted, during the interim phase of the 2008–09 audit, in relation to the quality assurance and reporting processes over financial transactions. Our review of these processes will be completed in the 2008–09 final audit.

Financial Management Information System

4.92 In 2007–08 the ANAO continued to report inappropriate segregation of duties relating to user access management, insufficient review processes surrounding application security for the Financial Management Information System (FMIS) and weaknesses in relation to user access management and configuration settings within the FMIS.

4.93 At the completion of the 2008–09 interim audit, improvements were noted in relation to user access management and the review processes surrounding application security. A new issue has been identified regarding the high number of users with access to sensitive financial transactions. Remediation activity in relation to all other issues remains outstanding.

Purchase to Pay

4.94 Consistent with prior years, control weaknesses were noted in relation to the purchasing and payment systems and business processes known as ‘Purchase to Pay’. These issues related to accounts payable management, the Card Management System³² (CMS), the Master Supplier Register³³ (MSR) and the Invoice Scanning and Imaging System³⁴ (ISIS) and include the need to:

- strengthen procurement delegations and approvals procedures and the need to implement controls to prevent the processing and payment of duplicate invoices;
- improve the data quality and management of vendor records;
- improve compliance with policies and procedures for the management and use of purchase and travel cards;
- address deficiencies in the change management framework for the MSR; and
- address weaknesses in the change management and user access management frameworks for ISIS.

³² The Card Management System is the system used to manage Defence’s corporate credit card transactions.

³³ The Master Supplier Register is Defence’s single authoritative source for vendor related data.

³⁴ The Invoice Scanning and Imaging System is the system used to increase the efficiency of payments made on invoices received by utilising data imaging technology.

4.95 The extent of these issues in relation to 'Purchase to Pay' has limited the ability of the ANAO to place reliance on purchasing controls and resulted in the extension of controls and substantive testing as part of the 2008–09 audit.

Human Resource Management

4.96 The Human Resource (HR) management systems for Defence are PMKeyS for all civilian personnel transactions and military leave processing and recording, and ADFPay for military payroll processing. At the completion of the 2007–08 audit, the ANAO reported the following issues:

- the need to improve record keeping procedures, exception processing and payroll processes for civilian and military employees;
- the need to improve the performance and review of input reports in ADFPay; and
- the need to reconcile records from the PMKeyS interface with ADFPay.

4.97 At the completion of the 2008–09 interim audit phase, Defence had initiated improvements in relation to systems, processes and procedures, however these are yet to be fully implemented and reviewed by the ANAO.

IT Governance

4.98 Defence is undergoing a number of strategic reforms in relation to Information and Communications Technology. The ANAO has reported a number of moderate risk issues in relation to IT governance including in the areas of IT strategic planning documentation, organisational wide business continuity management framework and bureau of service arrangements and shared services agreements with DMO.

4.99 Good IT governance practices provide the opportunity to more effectively manage and control IT projects, investments and/or services. Such practices also facilitate the alignment of IT with strategic goals and objectives, including maintaining the integrity of systems and processes impacting on the financial statements. Strategic documents set executive management expectations from which all other IT activities are directed.

4.100 The lack of current key strategic planning documents creates an exposure that business decisions are not aligned to organisations goals and executive management's expectation, including future capability requirements. Without appropriate management oversight, control and maintenance of information technology within the Defence control environment, Defence

cannot be reasonably assured that there is an appropriate level of rigour applied to key control activities impacting upon financial, operational and management information and the integrity of transactions.

Logistics Management General Stores Inventory (GSI) and Specialist Military Equipment (SME)

4.101 In 2007–08 Defence completed comprehensive remediation activity to address GSI quantities and legacy pricing issues. However, at the completion of the 2007–08 audit, a number of significant and moderate rated issues remained outstanding in relation to:

- the analysis and management of variances from the reconciliation of the inventory system (SDSS) and the financial management system (ROMAN);
- the need for specific remediation over purchasing and pricing processes, and in particular, for workshop orders which are a type of purchase order;
- management oversight of pricing remediation activities in relation to items purchased prior to 2000;
- improving controls and documentation in relation to the cyclical stocktake program of inventory and assets;
- reviewing the management reporting processes of stocktake results to the DAC;
- improving procedural documentation and controls around the use of queries and databases in the performance of GSI verification activities;
- the completeness and integrity of records of SME and commercial vehicles;
- the remediation and processing of Royal Australian Navy returns;
- inconsistencies in the financial classification and the combination of stock type and stock classifications in contradiction of policy outlined in the Defence Supply Chain Manual;
- the verification and stocktaking of Repairable Items holdings; and
- inventory purchased by Defence and issued to contractors which were not recorded on the inventory system.

4.102 Defence and the ANAO carried out sufficient work to be confident that the 2007–08 inventory balances were not materially misstated. However, the underlying inventory systems require ongoing remediation. In response, Defence has established the 2008–09 Inventory Assurance Program that focuses on inventory system controls and the accuracy of the inventory price and quantity records.

4.103 The focus by Defence on these areas has resulted in one significant risk issue being resolved. However, a number of significant and moderate issues continue to remain outstanding with regard to Defence’s logistics management.

4.104 These issues limit the ANAO’s ability to place reliance on specific inventory management and purchasing controls for the 2008–09 audit. Accordingly, the ANAO audit has focussed on validating the effectiveness of Defence’s Inventory Assurance Program and conducting extended detailed transaction testing at Defence establishments across Australia.

Conclusion

4.105 Defence’s commitment to implementing an assurance framework and a continued focus on developing a robust and reliable internal control environment, has resulted in the removal of one significant audit finding and a overall reduction in moderate rated audit findings. Critical to the ongoing improvement in the level of outstanding audit findings is the need to maintain an entity-wide focus on remediation activities and the implementation and ongoing monitoring and maintenance of control activities.

Defence Materiel Organisation

Business operations

4.106 The Defence Materiel Organisation (DMO) – Australia’s largest project management organisation – is the primary service delivery agency responsible for equipping and sustaining the Australian Defence Force (ADF), through the acquisition of capital equipment assets and their subsequent sustainment. The DMO also provides industry and procurement policy, and advice to the Department of Defence (Defence) and the Government.

4.107 The DMO is a prescribed agency under the FMA Act and is required to prepare annual audited financial statements. The DMO’s business is principally driven by objectives set by the Australian Government, Defence

policies and the operational requirements of the ADF. The DMO budgets for a break even operating result with income and expenditure equalling each other. This reflects DMO's operational model where the organisation is funded for the activity it performs. DMO receives the majority of its funding from Defence, formalised through a suite of agreements covering acquisition, sustainment, military workforce and shared services provided to or by Defence. These agreements set out details of products and services to be delivered and the responsibilities and accountabilities of each party.

4.108 On 23 September 2008 the results of the Defence Procurement and Sustainment Review (the Mortimer Review) were tabled in the Parliament. In response, the Government has endorsed a plan that will change the way Defence develops, acquires and sustains military capability. Accordingly, the DMO will implement a significant change program to become more business-like in support of its Defence customer. These changes build on the program of reform initiated by the 2003 Defence Procurement Review (the Kinnard Review).

4.109 The DMO's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	95	
Appropriation revenue	95	
Administered income		
Administered expense		
Total assets	2 402	
Total liabilities	2 175	

DMO's estimated average staffing level for 2008–09 is 5390.

Understanding the environment

4.110 As part of the DMO's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are the DMO's corporate governance arrangements and financial reporting framework.

Corporate governance

4.111 The key elements of DMO's corporate governance that contribute positively to the financial management regime of the agency include:

- monthly meetings between the CEO and division heads to discuss key strategic and operational issues;
- the Defence Procurement Advisory Board whose primary role is to monitor the implementation of the recommendations of the Kinnard Review and provide advice and support to the Secretary of Defence and the CEO of the DMO on strategic issues. The Board is accountable to the Minister for Defence and the Minister for Finance and Deregulation. Its governance role is likely to change as a result of subsequent reform activities, resulting from the Mortimer Review, the Defence White Paper and Defence Strategic Reform Program;
- the Materiel Assurance Boards – (Aerospace, Maritime, Land, Electronic, Explosive Ordnance Systems and Information Technology) provide advice, review and assurance over the acquisition and sustainment activities for each division. These Boards report through the respective General Managers to the CEO on the adequacy of the governance framework, advise of systematic issues arising within divisions or across the DMO, and the management of risks and issues relating to schedule, cost, capability, sustainability and the ability to achieve activity outcomes;
- the Materiel Audit and Risk Committee (MARC) – the MARC's primary objective is to assist the CEO of the DMO in discharging his responsibilities under the FMA Act and related legislation. The Committee achieves this through monitoring and advising on: risk management; the efficiency and effectiveness of the existing control framework; external accountability; legislative compliance; and internal and external audit. The MARC reports to the CEO annually as well as quarterly to the Defence Procurement Advisory Board. The MARC is comprised of five independent members and formally meets six to seven times per year;
- an internal audit function, with an audit work program (AWP) developed and delivered by the DMO's contracted internal auditors. The AWP is approved by the MARC and utilises Defence's Management Audit Branch to deliver assurance activities;

- fraud control governance arrangements that include a Fraud Control Plan, Chief Executive Instructions (CEI) on Fraud Control, and regular reporting to the MARC on fraud control;
- a Risk Management Framework which includes six-monthly reports to the Executive and the MARC on implementation of the Enterprise Risk Assessment and Management Plan, the maintenance of the Defence Materiel Instructions on Risk Management, and the completion of subordinate risk plans for each division of the DMO; and
- provision of Acquisition and Sustainment Overview Reports to Defence, the Defence Committee and the Procurement Advisory Board. The monthly reports include financial and non-financial information on the delivery of Defence capability.

Financial reporting framework

4.112 The ANAO's understanding of the DMO and its environment has enabled the risk of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.113 The ANAO has assessed the risk of material misstatement in the DMO's 2008–09 financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the use of numerous, complex and distributed business and IT processes across acquisition, sustainment and corporate activities, supporting the delivery of project management information throughout the DMO;
- complexities surrounding the assessment and implementation of accounting treatments and service delivery arrangements between the DMO and Defence;
- system and data integrity issues within the Standard Defence Supply System (SDSS), the key operational information system used to record and report Inventory and Repairable Items purchased on behalf of Defence;
- the timeframe within which DMO are required to prepare and deliver the financial statements; and

- issues associated with accounting for assets purchased and not capitalised and assets under construction reported in Defence's financial statements.

4.114 The risk assessment was further informed by the following factors which, to some extent, mitigate a number of the factors noted above:

- the strengthening of the financial reporting controls and assurance framework by the Finance Division, including improvements in management assurance over financial reporting;
- rolling monthly Quality Assurance (QA) reviews over financial statement line items;
- monthly and quarterly reporting on Assets Under Construction (AUC);
- appraisal by Project Evaluation Reviews to mitigate risks and issues in a timely manner;
- progressive standardisation of IT applications and implementing control frameworks; and
- strengthening of the assurance function by engaging an external service provider to develop and deliver internal assurance activities.

Audit results

4.115 The following table provides a summary of the status of prior year issues as well as 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	1	0	0	1	(1)**	0	0
B	11	(3)*	2	10	(2)*	4	12
Total	12	(3)	2	11	(3)	4	12

* Reporting of Commitments reclassified to Category C

** Closed and reassessed as 2 Category B findings

Moderate Risk Matters — Category B

Financial management and reporting framework

4.116 Since the establishment of the DMO, the ANAO has reported a significant audit finding in relation to the DMO's financial management and reporting framework. The DMO has progressively improved the quality of financial reporting by implementing a number of initiatives including:

- identifying key requirements relevant to the reporting of individual financial statement line items;
- documenting the key sources of information used in the compilation of financial statement balances;
- identifying key financial reporting controls for accurate and complete reporting of financial statement balances;
- documenting current and proposed management assurance and monitoring activities, including the frequency of quality assurance review activity designed to provide assurance on the reliability of controls and processes; and
- the development of a Controls and Assurance Framework for financial reporting over the preparation and delivery of the 2008–09 financial statements and to strengthen quality assurance activities.

4.117 The DMO has recently advised the ANAO it had completed a number of remediation activities that it considers address this finding, although the ANAO is yet to fully confirm the effectiveness of remedial action taken. To date, DMO has remediated components of the finding. As a result, the residual issues are now reported as two separate moderate risk issues; Financial Reporting and Controls Assurance Framework and Cost of Goods Sold.

Financial Reporting and Control Assurance Framework

4.118 The DMO continues to strengthen its internal control with the implementation of a controls and assurance framework for financial reporting in 2008–09 with a program of controls testing being conducted for the period up to December 2008. The ANAO will finalise its review of the work undertaken, including the results of the remaining program of testing, during the 2008–09 final audit.

Cost of Goods Sold

4.119 In 2007–08, the DMO was unable to provide all supporting documentation and adequate management assurance over significant components of the Cost of Goods Sold balance. In addition, the Goods Receipt / Invoice Receipt (GR/IR) clearing account contained a significant amount of items that had not been reviewed for 12 months.

4.120 In response, the DMO established a project to systematically review and clear the GR/IR clearing accounts, established guidelines and processes for the management of these accounts, and implemented strategies to ensure that supporting documentation is available in a more timely manner. The ANAO will review these remediation activities during the final phase of the 2008–09 audit.

Controls within the purchasing and payment process

4.121 In prior years, a number of issues were identified in the purchasing and payment process regarding the appropriate use of delegation limits. As a result, the ANAO was unable to gain reasonable assurance that purchases were made within appropriate delegation limits due to inconsistencies in the delegation details provided on purchase orders.

4.122 During the 2008–09 interim audit, the ANAO continued to identify a number of issues regarding the approval and exercise of delegations. The ANAO will continue to review this issue during the 2008–09 final audit.

Validity of revenue recognised

4.123 In 2005–06 and 2007–08, the ANAO reported an issue regarding revenue recognition for Supply Chain Assets (spares) within the DMO's financial statements. The Defence-DMO business model allows the DMO to recognise revenue for sustainment activities on the receipt of goods into an appropriate system.

4.124 The ANAO will review DMO's position paper regarding revenue recognition during the 2008-09 final audit. Consideration will be given to both the DMO's financial statements and any impact on the asset base reported in Defence's financial statements.

Accrued expenses, prepayments and contingencies

4.125 The DMO utilises information collection packs (jobkits) to gather and collate financial information from business units for inclusion in the monthly and annual financial statements. The jobkits form part of the DMO's financial

reporting framework and are a key financial control over the completeness, valuation and accuracy of expenditure, accruals and prepayments.

4.126 In 2007–08, the ANAO identified weaknesses in the collation of the jobkits that has resulted in the incomplete and inaccurate reporting of financial information. This increases the risk of omitting material information from the financial statements.

4.127 During the 2008–09 interim audit, the ANAO continued to identify weaknesses in the capture and reporting of financial information in the jobkits. The DMO is undertaking staff training and a review of the processes involved in the collation of the information collection packs. The ANAO will review these activities during the 2008–09 final audit.

Shared service arrangements

4.128 The ANAO has a moderate risk issue regarding shared services arrangements between Defence and DMO over key financial systems, the human resources management system (PMKeys) and supporting IT general controls.

4.129 A Shared Service Agreement, between DMO and Defence, was signed in June 2006. This agreement was to be updated on an annual basis to reflect any changes or evolution in the agencies' activities or their respective environments.

4.130 Current arrangements do not provide mechanisms that allow the DMO to obtain the necessary assurance, from Defence, over the effectiveness and adequacy of controls in the financial management information system, the human resource management system and the supporting IT general controls, such as systems security and change management. The DMO requires assurance over the integrity of transactions process by these systems as they are reported in DMO's financial statements.

4.131 In addition, the arrangements should include requirements by which DMO provides assurance to Defence over the effectiveness and adequacy of controls for the inventory systems managed by DMO but impacting on Defence's financial statements.

4.132 The ANAO considers that the Agreement should be updated, or alternative arrangements established to reflect these matters.

Business Continuity Planning

4.133 The DMO has an enterprise wide Business Continuity Plan (BCP), however the Plan is not current and has not been tested. In the absence of a current, integrated and tested BCP, existing business continuity arrangements may prevent the DMO from restoring critical business processes and systems within an acceptable timeframe, in the event there is an interruption to operations.

Alignment of supply chain processes to policy and procedures

4.134 In 2007–08, the ANAO's review of SDSS controls noted that a number of supply chain processes were not reflected in the SDSS IT Controls Framework or other policy and procedural documentation, such as the Defence Supply Chain Manual (DSCM). In addition, not all users were aware of changes to mandatory guidance and explanatory material within the control framework.

4.135 This situation increases the risk that supply chain transactions will be processed incorrectly or not in compliance with the control framework. The ANAO is reviewing this issue and will report its status as part of the 2008–09 final audit.

SDSS IT controls framework and management assurance activities

4.136 The SDSS IT controls framework provides Defence and the DMO with a control framework to support the requirements for the management of supply chain processes outlined in the Defence Supply Chain Manual. The framework's primary objective is to enhance the operation, reliability and information quality of the transactions supported by the supply chain system and processes.

4.137 In 2007–08, the ANAO tested compliance with the framework, and the performance and reliability of third party management assurance activities. The ANAO identified a number of issues with the approach adopted and the testing of the framework including: the sampling approach utilised; the reliability of conclusions drawn for work completed; the completeness of controls tested; and limitations of evidence to support test results. As a result, the ANAO's 2008–09 audit continued to place a reduced level of reliance on the framework. In particular, a low level of controls reliance over General Store Inventory and a low to moderate level of controls reliance over Repairable Items.

4.138 At the date of this report the ANAO was reviewing supply chain systems and processes at a number of locations across Australia. This activity

is performed in conjunction with the annual stock take of General Stores Inventory and Repairable Items, and includes observation of management assurance activities performed by Defence and DMO personnel to test the framework.

4.139 Preliminary stocktake results indicate that there continues to be weaknesses in the performance of the underlying internal controls. As a result, the ANAO has adopted alternative audit procedures over the affected transactions and balances.

SDSS Controls Framework: Security Compensating Controls

4.140 In 2004–05, the ANAO identified a significantly high number of users with high levels of access to the inventory system, SDSS. In response, the DMO implemented a number of compensating controls to manage the risk of inappropriate or unauthorised access to business and financial transactions within SDSS, until full remediation of the access issue could be completed.

4.141 The ANAO continues to identify weaknesses in the compensating controls, including insufficient level of management oversight and review, reporting requirements not being met and inadequate access to reporting functionality. In addition, an increasingly high number of users retain access rights that (in comparison to prior years) are not commensurate with the control framework.

4.142 At the date of this report the ANAO was reviewing the status of these issues.

Allocation of costs within projects

4.143 Since 2004–05, the ANAO has noted control and methodology issues in the valuation of assets to be rolled out to Defence. DMO manages the allocation of costs within projects, and when accepted by Defence, these assets are rolled out and reported in Defence’s financial statements.

4.144 The issues noted included assets not being rolled out in a timely manner due to unresolved errors in the Budget Costing Models (BCMs); variability in the quality of the BCMs, including a lack of supporting documentation of review activities, approvals, source data and assumptions used; the inconsistent allocation of overheads, project management costs and price indexation in the BCMs; and changes in project scope not being captured in the BCMs. These factors increase the risk of errors in the value of Specialist

Military Equipment (SME) asset balances and of non-compliance with capitalisation policies.

In response, the DMO has performed a number of remediation activities, including a review of the BCM template and AUC rollout checklist, analysis and monitoring of the Monthly Reporting System (MSR) and refinement of processes with Defence. The ANAO will assess the status of this issue during the 2008–09 final audit.

Processing and completeness of asset roll-outs

4.145 The ANAO continues to observe issues with the timeliness and consistency in the processing and completeness of asset roll-outs, resulting in significant adjustments to the AUC and SME depreciation balances reported in Defence's financial statements. While improvements are continuing to be made, this matter is yet to be fully resolved.

4.146 In response, the DMO has performed a number of remediation activities referred to above in relation to the allocation of costs within projects. The ANAO will also assess the status of this issue during the 2008–09 final audit.

Conclusion

4.147 The internal control issues identified reduce the level of confidence the DMO can place on information sourced from key financial systems. As a result, the DMO undertakes additional assurance activities and needs to continue to work closely with Defence to ensure that issues impacting on either agency are adequately addressed.

4.148 The remediation of the identified control issues will provide a greater level of confidence over the DMO's financial management reporting regime.

Department of Veterans' Affairs

Business operations

4.149 The Department of Veterans' Affairs (DVA) provides administrative support to the Repatriation Commission and the Military Rehabilitation and Compensation Commission, and is responsible for:

- advising both Commissions on Australian Government policies and programs for beneficiaries; and

- administering these policies and programs.

4.150 The Repatriation Commission is responsible under the *Veterans' Entitlements Act 1986* for granting pensions, allowances and other benefits, providing treatment and other services and generally administering this Act. The Military Rehabilitation and Compensation Commission is responsible for determining claims under the:

- *Military Rehabilitation and Compensation Act 2004* for serving and former members of the Australian Defence Force; and
- *Safety Rehabilitation and Compensation Act 1988* for serving and former members of the Defence Force and certain Australian Federal Police personnel with approved overseas service.

4.151 In addition to supporting both Commissions, DVA administers legislation such as the *Defence Service Homes Act 1918* under which housing assistance is provided.

4.152 DVA's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	326	
Appropriation revenue	327	
Administered income		9
Administered expense		11 603
Total assets	170	1 128
Total liabilities	121	2 362

DVA's estimated average staffing level for 2008–09 is 2090.

Understanding the environment

4.153 As part of DVA's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DVA's corporate governance arrangements and financial reporting framework.

Corporate governance

4.154 The key elements of DVA's corporate governance that contribute positively to the financial management regime of the department include:

- an executive board 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 governance committee framework, including an Audit and Risk Committee that oversees and provides direction to risk management activities and assesses outcomes of external reviews of programs including follow-up actions. The Committee also has a monitoring role in relation to the progress of internal audit and 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; and
- the development of a fraud risk profile, which is undertaken every two years and is directly linked to DVA's fraud control activities.

4.155 At the time of the audit, DVA's risk management framework was under review. DVA intends to review its enterprise risk management plan once the risk management framework has been updated.

Financial reporting framework

4.156 DVA has developed a financial reporting framework that includes monthly reports on administered and departmental revenues, expenses, assets, liabilities and cash flows. The reports include explanations for variances from budgeted or forecast outcomes on both an accruals and cash basis, and provide additional information on specific areas of interest to the executive board.

4.157 The monthly reports include both financial and non-financial information. This information is used to assess performance against cost, quality and timeliness of information and outcomes as set by management.

Identifying financial reporting risks

4.158 The ANAO's understanding of DVA and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.159 The ANAO has assessed the risk of material misstatement in the 2008–09 DVA financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the dependence of service delivery on complex IT systems;
- the diverse range of entitlements administered by DVA and the reliance placed upon voluntary disclosure by recipients;
- reliance on Medicare Australia to make health care payments to veterans;
- the complexity of contractual arrangements with service providers, institutions, and state governments; and
- the large volume of legislative requirements that DVA must adhere to and the extent of changes to legislation.

Audit results

4.160 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	1	1
Total	1	(1)	0	0	0	1	1

Moderate Risk Matters — Category B

4.161 The ANAO reported one new moderate control weakness during the interim phase of the 2008–09 audit. This was in relation to the quality assurance framework over the payments made under the *Military Rehabilitation and Compensation Act* and *Safety Rehabilitation and Compensation Act*.

4.162 The quality assurance framework should be strengthened by ensuring that the framework addresses business risks and quality assurance, testing is

completed in a timely manner and appropriately reviewed, and the results reported to management.

Conclusion

4.163 Based on the audit work performed to date, except for the matter outlined above, key internal controls are operating satisfactorily to provide reasonable assurance that DVA can produce financial statements free of material misstatement.

Education, Employment, and Workplace Relations Portfolio

Department of Education, Employment and Workplace Relations

Business operations

4.164 The Department of Education, Employment and Workplace Relations (DEEWR) provides advice to the government and administers programs to achieve the Government's objectives for education, employment and workplace relations. DEEWR works in partnership with the states and territories, non-government authorities, providers and industry towards achieving its outcomes.

4.165 The Government has announced a productivity agenda which includes an education revolution, workplace relations reform, workforce participation and social inclusion. The productivity agenda aims to improve Australia's productivity growth rate. DEEWR has responsibility for a central part of the Government's strategy which aims to provide a sustained increase in the quantity of investment, and the quality outcomes across the education, skills and training system.

4.166 The DEEWR Executive undertakes an annual review of the department's strategic risks to ensure they remain current and relevant. In the light of changes in the global economic environment, the DEEWR Executive considered the impact of the Global Financial Crisis on the department's operations and financial statements. The impact of the GFC on the department's programs was assessed as being one of DEEWR's key strategic risks and was added to its Strategic Risk Statement. The key GFC risk areas identified include greater pressure on all sectors of DEEWR's business including employment services and education and training.

4.167 DEEWR's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	1 896	
Appropriation revenue	1 884	
Administered income		1 325
Administered expense		39 876
Total assets	473	16 478
Total liabilities	272	5 755

DEEWR's estimated average staffing level for 2008–09 is 5550.

Understanding the environment

4.168 As part of DEEWR's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DEEWR's corporate governance arrangements and financial reporting framework.

Corporate governance

4.169 The key elements of DEEWR's corporate governance that contribute positively to the financial management regime of the department include:

- an executive management group that meets fortnightly and addresses strategic issues, monitors DEEWR's financial performance, and oversees the operational performance of groups and programs;
- an audit committee that meets at least quarterly and focuses attention on internal controls, management of risks, review of financial reports, control of public monies and regulatory compliance;
- an internal audit function that has a planned risk based audit coverage of DEEWR's activities; and
- a fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines.

Financial reporting framework

4.170 DEEWR has developed a financial reporting framework that includes monthly reports on departmental revenue and expenses and administered expenses. The reports include explanations for variances from budgeted or expected outcomes and forecasts, and provide additional information on specific areas of interest to the executive.

Identifying financial reporting risks

4.171 The ANAO's understanding of DEEWR and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.172 The ANAO has assessed the risk of material misstatement in the 2008–09 DEEWR financial statements as high. The major factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the significance of administered activities;
- reliance on actuarial assessments for the valuation of complex administered balances;
- reliance on third parties to provide information that is critical to support payments made under a variety of programs including employment services, child care, grants and unfunded university superannuation;
- reliance on other agencies' systems, including Centrelink and FaHCSIA, to process payments on behalf of DEEWR (for example childcare and personal benefits);
- a complex IT environment supporting multiple business processes;
- the challenge of integrating the business processes from the former departments including managing across two financial management information systems; and
- changes resulting from the COAG federal financial relations reforms. This changes the manner in which the payment of National Specific Purpose Payments and National Partnership Payments to the States and Territories are made from 1 January 2009.

Audit results

4.173 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	0	0	1	1	0	0	1
Total	0	0	1	1	0	0	1

4.174 The 2007–08 audit highlighted the following issue that should be addressed to support the preparation of the financial statements in 2008–09.

Moderate Risk Matter—Category B

Financial Statement Preparation

4.175 The timely preparation and publication of annual audited financial statements is an important aspect of financial management and stewardship, and the primary mechanism by which DEEWR meets its financial accountability obligations. In 2007–08, extensive MOG changes contributed to shortfalls in the financial statement preparation process that resulted in DEEWR not meeting its financial statement obligations in a timely manner.

4.176 DEEWR has since undertaken a review of the financial statement preparation process and presented to the Audit Committee a Financial Statement Project Plan. The plan focuses on improvements in project management, timeframes for key components of financial statement preparation, quality control and assurance processes and the preparation of appropriate levels of documentation to support the financial statements. Given the remedial action undertaken by DEEWR, it is anticipated that this finding will be resolved as part of the 2009 final audit.

Conclusion

4.177 Based on audit work performed to date, internal controls are operating satisfactorily to provide reasonable assurance that DEEWR can produce financial statements that are free of material misstatement.

The Environment, Water, Heritage and the Arts Portfolio

Department of the Environment, Water, Heritage and the Arts

Business operations

4.178 The Department of the Environment, Water, Heritage and the Arts (DEWHA) advises the Australian Government on its policies as they affect Australia's environment and heritage and Australia's Antarctic interests and is responsible for establishing and monitoring the policy parameters to enable the more efficient and sustainable use of Australia's water resources. DEWHA is also responsible for promoting the development of rich and stimulating cultural sectors for all Australians including preservation, maintenance of and access to Australia's cultural activities, national cultural collections and buildings and indigenous languages.

4.179 In 2008–09 the Australian Government announced new policies and programs to help Australian households and communities to better manage their impact on the environment. One major measure was to increase energy efficiencies and the use of renewable energy throughout the community. As a result DEWHA received an increase in funding for the *Solar Homes and the Communities Plan*.

4.180 DEWHA's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	481	
Appropriation revenue	446	
Administered income		26
Administered expense		1 970
Total assets	585	7 924
Total liabilities	338	50

DEWHA's estimated average staffing level for 2008–09 is 2561.

Understanding the environment

4.181 As part of DEWHA's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. The two important factors considered relating to DEWHA's control environment were the corporate governance arrangements and the financial reporting framework.

Corporate governance

4.182 The key elements of DEWHA's corporate governance that contribute positively to the financial management regime of the department include:

- a senior executive committee that meets weekly to evaluate DEWHA's strategic direction, financial planning and operational results;
- an audit committee that meets at least quarterly and focuses on internal and risk management issues;
- an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives; and
- a structured framework for incorporating risk management into the broader management and business processes including the development of a fraud control plan.

Financial reporting framework

4.183 DEWHA has implemented a financial reporting framework that measures key financial and non-financial performance, promoting effective management of key business areas. DEWHA produces monthly reports on a timely basis and include variance analysis from budget and details specific areas that are of special interest to the Executive.

Identifying financial reporting risks

4.184 The ANAO's understanding of DEWHA and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.185 The ANAO has assessed the risk of material misstatement in the 2008–09 DEWHA financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused include:

- the magnitude and complexities of its operations;

- the administration of a diverse number of grant programs;
- complexities surrounding the accounting and valuation issues associated with the relatively new area of purchasing and managing water entitlements;
- asset management, reporting and stocktake difficulties due to the remote localities of Antarctic asset holdings. This includes complex valuation of make good obligations for Antarctic assets;
- the integration and implementation of the grant management system 'Clarity' into the Financial Management Information System (FMIS); and
- the changes resulting from the Council of Australian Governments (COAG) federal financial framework reforms in relation to the manner in which the payment of National Specific Purpose Payments (SPPs) and the National Partnership Payments (NPs) to States will occur.

Audit results

4.186 There were no significant or moderate audit issues raised by the ANAO following the 2008–09 interim audit, or in the prior year.

Conclusion

4.187 Based on the audit work performed to date, internal controls are operating satisfactorily to provide a reasonable assurance that DEWHA can produce financial statements free of material misstatement. The ANAO will review the financial statement implications of the revised COAG arrangements for Specific Purpose Payments and National Partnership payments to the States and Territories during the 2008–09 final audit. The valuation of water entitlement assets is another matter that will be reviewed as part of the 2008–09 final audit.

Families, Housing, Community Services and Indigenous Affairs Portfolio

Department of Families, Housing, Community Services and Indigenous Affairs

Business operations

4.188 The Department of Families, Housing, Community Services and Indigenous Affairs' (FaHCSIA) role is to support Australian families and work towards closing the gap between Indigenous and non-Indigenous Australians. Central areas of focus include; improving the availability and affordability of housing; relieving pressures on carers, seniors, people with disability and parents; strengthening communities; and providing national leadership to protect children from abuse and neglect.

4.189 These responsibilities are encapsulated in FaHCSIA's four performance outcomes:

- greater self-reliance and economic, social and community engagement for Indigenous Australians – where services and assistance promote greater self-reliance and engagement for Indigenous families and communities through: shared responsibility; practical support; and innovative whole-of-government policy;
- seniors, people with disabilities, carers, youth and women are supported, recognised and encouraged to participate in the community – where services and assistance help people to: participate actively in the community and economic life; access a responsive and sustainable safety net; and develop their capabilities;
- families and children have choices and opportunities – where services and assistance help children have the best possible start to life; promote healthy family relationships; help families adapt to changing economic and social circumstances; and
- strong and resilient communities – where services and assistance help homeless people and low income households to gain appropriate and affordable housing; promote community partnerships; and encourage

participation in the local community by individuals, families, business and government.

4.190 FaHCSIA's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	1 662	
Appropriation revenue	1 658	
Administered income		489
Administered expenses		75 475
Total assets	422	4 383
Total liabilities	227	7 605

FaHCSIA's estimated average staffing level for 2008–09 is 2639.

Understanding the environment

4.191 As part of FaHCSIA's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls structure. As a result of the COAG reforms the Department of Treasury is now responsible for making special purpose payments to state and territory governments and FaHCSIA retains the policy responsibilities over the programs. This will have an impact on the reporting of administered grants payments in FaHCSIA's financial statements. At an operational level these revised payment arrangements have had minimal impact on FaHCSIA's business systems as the majority of its functions are personal benefit payments that are processed by Centrelink.

4.192 Two of the important factors considered, relating to FaHCSIA's environment, were its corporate governance arrangements and financial reporting framework.

Corporate governance

4.193 The key elements of FaHCSIA's corporate governance that contribute positively to the financial management regime of the department 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 Financial Officer;

- a committee framework, including a Risk Assessment and Audit Committee (RAAC). The RAAC 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;
- an Internal Audit and Fraud Branch that undertakes a risk based audit coverage of FaHCSIA's activities;
- a fraud control plan covering the period 2007–09; and
- a risk management framework encompassing a Risk Management Unit, that is responsible for coordinating and developing FaHCSIA's risk management regime, and a Risk Management Toolkit that encourages staff to apply risk management principles.

Financial reporting framework

4.194 FaHCSIA's approach to financial reporting includes monthly performance reports to the EMG on actual results against budget and a performance scorecard in relation to departmental financials. The information provided to management includes high-level analysis of the financial position of FaHCSIA, an analysis of variances from budget, and monthly financial statements.

Identifying financial reporting risks

4.195 The ANAO has assessed the risk of material misstatement in the 2008–09 FaHCSIA financial statements as moderate. FaHCSIA's strong control environment, corporate governance and improved financial statement reporting have contributed to the reduction of the risk rating from high in 2007–08 to moderate. The factors that have contributed to this risk assessment, and which the financial statement audit is particularly focused, include:

- the reliance on Centrelink's systems and processes to deliver personal benefit payments on behalf of FaHCSIA. These personal benefit payments are based on voluntary disclosures by recipients;
- the complex estimation of the Family Tax Benefit and Pension Bonus Scheme provisions, personal benefit overpayments and the impairment of debts and;

- complexities associated with the management of grant programs in the light of the requirement for recipients to comply with numerous grant payment conditions.

4.196 As part of the risk assessment process, the ANAO considered the impact of the Global Financial Crisis (GFC) on FaHCSIA's operations and its financial statements. While there has been a substantial increase in benefit payments associated with the Government's financial stimulus initiatives, the GFC is not expected to have any other significant impacts on FaHCSIA's financial statements.

Audit results

4.197 The following table provides a summary of the status of prior year issues. No new audit issues were raised by the ANAO in 2008–09.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	0	0
Total	1	(1)	0	0	0	0	0

Conclusion

4.198 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that FaHCSIA will be able to produce financial statements free of material misstatement.

Finance and Deregulation Portfolio

Department of Finance and Deregulation

Business operations

4.199 The Department of Finance and Deregulation (Finance) assists the Government across a wide range of policy areas to ensure its outcomes are met, particularly with regard to expenditure and financial management, deregulation reform and the operations of government.

4.200 Services delivered by Finance include supporting the delivery of the Australian Government Budget, the ongoing management of the Australian Government's non-defence domestic property portfolio and key asset sales. Finance is also responsible for implementation of the Australian Government's deregulation agenda and the financial framework for Australian Government agencies. Additionally, Finance provides entitlements advice and support to parliamentarians and their employees; maintains shareholder oversight for Government Business Enterprises (GBEs); provides general insurance services to government agencies; administers investment funds; and promotes improved risk management. Finance also provides strategic advice, guidance and service provision for the productive application of new and existing information and communication technologies to government operations.

4.201 Finance's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	207	
Appropriation revenue	246	
Administered income		1 627
Administered expenses		6 954
Total assets	1 811	23 612
Total liabilities	319	78 107

Finance's estimated average staffing level for 2008–09 is 1390.

Understanding the environment

4.202 As part of Finance's financial statement audit, the ANAO gained an understanding of the agency and its environment, including its internal controls. Two of the important factors considered were Finance's corporate governance arrangements and financial reporting framework.

Corporate governance

4.203 The key elements of Finance's corporate governance that contribute positively to the financial management regime of the department include:

- an executive board that meets weekly and addresses policy, program, strategic and management issues and provides oversight of Finance's operational and financial performance;
- an audit committee, chaired by an independent member, that meets at least quarterly and focuses on risk management, internal controls, compliance, financial reporting and ANAO activities;
- an internal audit function that has a planned risk based coverage of Finance's activities;
- a risk management process which includes an assessment of inherent and control risks, identification of the controls in place to address these risks both at an organisational and discrete activity level and an understanding of the residual risks that remain and how these can be managed to an acceptable level ; and
- a fraud risk assessment process and fraud control plan.

Financial reporting framework

4.204 Finance has developed financial reporting processes that provide monthly reports on administered and departmental revenues, expenses, assets and liabilities and cash flows within seven days of month end. The reports provide actual versus budget information on an accrual basis, allowing Finance to assess its financial position and operating performance. The reports also provide non-financial information including overview of key performance indicators, human resource issues, and the impact of possible future adverse events.

Identifying financial reporting risks

4.205 The ANAO's understanding of Finance and its environment enabled the risks of material misstatement in the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.206 The ANAO has assessed the risk of material misstatement in the 2008–09 Finance financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the complexity of the assumptions and calculations underpinning the actuarial assessment of the public sector unfunded superannuation liability;
- the valuation of the Australian Government's domestic property portfolio and the adequacy of asset management procedures;
- the management and reporting of the Australian Government's self-managed general insurance fund (Comcover);
- the validity and accuracy of entitlements paid to Parliamentarians and their staff; and
- the management and reporting of the newly established Nation Building Funds.

Audit results

4.207 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	2	2
Total	0	0	0	0	0	2	2

4.208 The 2008–09 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matter—Category B

Credit Card Acquittal

4.209 Finance has 225 credit card holders. A key control over credit card expenditure is to ensure it is acquitted in a timely manner. In October 2008, following the implementation of a new Financial Management Information Systems (FMIS), Finance identified system issues that prevented automated acquittal processes from occurring. As a result, no credit card expenditure was acquitted for the five month period October 2008 to February 2009 and no alternative or compensating control was put in place. As a result, there was an increased risk of fraudulent or incorrect credit card transactions occurring and not being identified and resolved in a timely manner. Finance has largely completed the acquittal process for the October 2008 to February 2009 period, and is following up a small number of potentially fraudulent transactions with its credit card provider.

Accounts Processing User Access

4.210 The ANAO conducted a user security review of information systems identified as significant to Finance's financial statements. This review identified a user who had access to change invoice and vendor details while having payment approval access for a three month period October 2008 to January 2009. This weakness exposed Finance to an increased risk of unauthorised and inappropriate access or changes to invoices or vendor details. Finance has subsequently changed the user's access to an appropriate level and has advised the ANAO that reports subsequently produced have shown that this access was not used inappropriately.

Conclusion

4.211 Based on the audit work performed to date, with the exception of the matters noted above, key internal controls are operating satisfactorily to provide reasonable assurance that Finance can produce financial statements free of material misstatement.

The Board of Guardians and the Future Fund Management Agency

Business operations

4.212 The Future Fund Management Agency (FFMA) was established by the *Future Fund Act 2006* to support and advise the Future Fund Board of Guardians in its task of investing the assets of the Future Fund.

4.213 In 2008–09 the responsibilities of the FFMA and the Future Fund Board of Guardians have been extended to include the management of other Australian Government Asset Funds as a means to provide financing sources for substantial future investments in the Australian economy.

4.214 Investment, other than cash, by the Future Fund commenced in June 2007. Investments are made in accordance with an investment strategy approved by the Board of Guardians, consistent with the Investment Mandate given to the Board by the Government.

4.215 The assets of the Higher Education Endowment Fund (HEEF) were invested in accordance with the Investment Mandate issued by the responsible HEEF Ministers in October 2007. This investment strategy continued until the HEEF was closed and its funds were subsumed into the Education Investment Fund (EIF) in December 2008.

4.216 The FFMA now also has responsibility for the investment and management of assets relating to the newly established Building Australia Fund, Education Investment Fund and Health and Hospitals Fund.

4.217 The FFMA’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	0 *	
Appropriation revenue	0 *	
Administered income		3 450
Administered expenses		8 706
Total assets	7	59 040
Total liabilities	7	16

*Pursuant to the *Future Fund Act 2006*, the expenses of the Board of Guardians and the Future Fund Management Agency are funded by the Future Fund Special Account.

The FFMA’s estimated average staffing level for 2008–09 is 50.

Understanding the environment

4.218 Under the *Future Fund Act 2006*, the Board of Guardians, supported by the FFMA, is required to seek to maximise the return earned on contributions to the Fund over the long term, consistent with international best practice for institutional investment and subject to any directions provided by the responsible Ministers, the Treasurer and the Minister for Finance and Deregulation.

4.219 The Board’s core focus is overseeing the development of an investment strategy which will enable the organisation to meet its objectives outlined above. The approval and continuous monitoring of the investment portfolio’s target asset allocation is a key function of the Board.

4.220 The financial performance of the Future Fund and the Agency are reviewed each month by the Board of Guardians. The management accounts that are prepared for review include commentary on actual results to date.

4.221 The Agency has also developed a Risk Management Framework, including identification of the ‘Top 20’ risks within the Agency.

4.222 The Audit Committee has in place a formal Charter that sets out its responsibilities in relation to oversight of the financial reporting process, internal audit and risk management. The performance of the Audit Committee and the Charter that governs its function is subject to annual review.

Corporate governance

Internal control

4.223 The FFMA has developed a sound internal control framework and associated operating policies and procedures for the management of operations supporting investment activities. Controls over key agency operations, such as payroll and expenditure, have also been implemented and continue to develop as the FFMA grows.

4.224 Significant investment controls reside with the outsourced custodian. These controls are subject to an independent bi-annual internal controls audit as well as substantive audit as at 30 June each year of the existence and valuation of the investment portfolio. The Fund's investment positions are also reconciled regularly on a three way basis between the custodian, the investment manager, and the Fund's own records. Amongst other things, the ANAO's audit approach reviews these reconciliations and considers the processes involved in the Fund's monitoring of the performance of the external custodian against the service level agreement.

Fraud management

4.225 The FFMA has developed a Fraud Control and Prevention Plan, which has been ratified by the Board of Guardians. The plan and the processes contained within them will be subject to periodic internal audit.

4.226 Responsibility for the oversight of the Fraud Control and Prevention Plan rests with the Audit Committee.

Internal Audit

4.227 Internal audit is fully outsourced. A plan for 2009 has been established and approved by the Audit Committee. Oversight of the internal audit responsibility rests with the Audit Committee.

4.228 The Internal Audit plan for 2009 contains a review of key investment operations controls and processes and the ANAO intends to place reliance on this work where possible.

4.229 The performance of Internal Audit will be measured against agreed Key Performance Indicators.

Identifying financial reporting risks

4.230 Key audit risks are identified by an analysis of the FFMA's financial statements and operating environment, discussions with management, developments in the industry and from prior year audit work. The key audit risks identified for 2008–09 are:

- the recent volatility in world wide financial markets and the resulting impact on the valuation of investments;
- the administration and investment of three new funds (Building Australia Fund, Education Investment Fund and Health and Hospitals Fund);
- the incorporation of five wholly owned subsidiaries to be used as special purpose investment vehicles, which will require consolidation into the Future Fund financial report; and
- compliance monitoring and reporting including monitoring of external service providers such as the custodian.

Audit results

4.231 At the time of preparing this report, the interim audit was still in progress.

4.232 No significant or moderate audit issues were identified during the 2007–08 audit.

Conclusion

4.233 Audit results for the 2008–09 financial statements audit will be reported in the ANAO's year end report to the Parliament.

Foreign Affairs and Trade Portfolio

Department of Foreign Affairs and Trade

Business operations

4.234 The Department of Foreign Affairs and Trade (DFAT) provides foreign and trade policy advice to the Government. To advance the interests of Australia and Australians internationally, DFAT works towards achieving four outcomes:

- Australia's national interests protected and advanced through contributions to international security, national economic and trade performance and global cooperation;
- Australians informed about and provided access to consular and passport services in Australia and overseas;
- public understanding in Australia and overseas of Australia's foreign and trade policy and a positive image of Australia internationally; and
- efficient management of the Commonwealth overseas owned estate.

4.235 To do this, DFAT manages a network of approximately 90 overseas missions; employs around 3,400 staff; issues about 1.5 million passports and collects passport revenues of around \$300 million per annum; builds and maintains an information, communications and technology (ICT) platform that allows the secure transmission of information across its overseas network; pays out around \$200 million each year in contributions to international organisations; and oversees the Commonwealth owned estate whose value, at the end of 2007–08, approached \$1.6 billion.

4.236 DFAT’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	769	
Appropriation revenue	858	
Administered income		337
Administered expense		377
Total assets	2 882	357
Total liabilities	224	90

DFAT’s estimated average staffing level for 2008–09 is 3461.

Understanding the environment

4.237 As part of DFAT’s financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DFAT’s corporate governance arrangements and financial reporting framework.

Corporate governance

4.238 The key elements of DFAT’s corporate governance that contribute positively to the financial management regime of the department include:

- an executive committee that oversees the operational performance of divisions, reviews departmental wide issues, monitors financial performance and considers reports prepared and referred by other internal committees;
- a governance committee framework including an audit and risk committee. The audit and risk committee meets at least quarterly and focuses attention on the efficiency, effectiveness and probity of activities including risk assessment and management, internal audit planning and results, fraud control and ANAO audit activities;
- an internal audit strategy and plan that aligns with the department’s risk assessment and management priorities; and
- a fraud control plan that is monitored and reviewed in line with the Commonwealth’s Fraud Control Guidelines.

Financial reporting framework

4.239 DFAT has developed a financial reporting framework that incorporates key financial and non-financial measures to monitor performance and financial management. Monthly reports are produced for the executive committee to identify and explain variances between budgeted and actual information.

Identifying financial reporting risks

4.240 The ANAO developed an understanding of DFAT and its environment to enable the risks of material misstatement of the financial statements to be identified and assessed, so that appropriate audit procedures could be designed and performed to address those risks.

4.241 The ANAO has assessed the risk of material misstatement in the 2008–09 DFAT financial statements as moderate. The major factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- reliance on external service providers for key operations, including passport processing and revenue collection and the management and delivery of property services;
- the global geographical spread of operations: overseas missions are subject to decentralised review and approval processes, as well as being impacted by differing labour and other employment laws for locally engaged staff;
- the current global economic environment volatility and the potential impact on the valuation of the property portfolio and liabilities reliant on estimation techniques;
- a complex and dynamic IT environment supporting both on and off shore financial transactions; and
- an upgrade of the human resource management information system, including data migration.

Audit results

4.242 The following table provides a summary of the status of prior year issues as well as the 2008–09 interim audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	5	5
Total	0	0	0	0	0	5	5

4.243 The 2008–09 audit highlighted the following issues, categorised as moderate, that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matters—Category B

HRMIS Upgrade – Long Service Leave Liability

4.244 DFAT undertook an upgrade of its HR system with an implementation date of July 2008. DFAT identified a number of variances in the long service leave liability balances produced by the HR system prior to the upgrade and following the upgrade. DFAT was unable to fully reconcile the two balances. Consequently, DFAT could not complete the fortnightly leave liability reconciliation between the HR and the finance systems. As a result, the long service leave liability figure could not be confirmed as complete or accurate at the time of the interim audit. DFAT is working towards resolving this issue prior to the end of the financial year.

Management of Passport Revenue Collection

4.245 DFAT will collect approximately \$300 million in passport revenue in 2008–09. Approximately 80% of this is collected by an external service provider, Australia Post, under a contract for services arrangement. Formal policies and procedures and a strong reconciliation regime, particularly between DFAT and Australia Post information, are key controls in ensuring that passport revenue collection is accurately recorded and reported. The ANAO identified gaps in the documentation of passport revenue collection policies and procedures, and also found some weaknesses relating to the conduct of key reconciliations including delays in following up identified variances.

FMIS Security, Monitoring and Reporting

4.246 A review of IT security configuration controls over the FMIS identified a number of weaknesses including:

- a high number of users with access to sensitive or incompatible functions;
- several generic administrator accounts where the specific user could not be uniquely identified;
- a number of system parameters were not compliant with the Australian Government Information and Communications Technology Security Manual (ACSI 33); and
- insufficient evidence of the conduct and approval of monthly security reviews.

4.247 These control weaknesses increase the risk that inappropriate access and unauthorised activity, whether intentional or unintentional, may occur and not be detected by DFAT.

HRMIS Security, Monitoring and Reporting

4.248 The ANAO conducted a security review of the IT controls over the HR, PeopleSoft system and identified a number of weaknesses including:

- inadequate password controls;
- the use of generic accounts where the specific user could not be uniquely identified;
- a lack of review of user log reports as required by DFAT's security framework; and
- no segregation of duties matrix detailing appropriate access combinations.

4.249 These control weaknesses increase the risk that inappropriate access and unauthorised activity, whether intentional or unintentional, may occur and not be detected by DFAT.

Enterprise Wide Business Continuity Management

4.250 DFAT has in place an agency wide Business Continuity Plan (BCP) supported by BCPs for each division and overseas mission, and associated Disaster Recovery Plans (DRP) for specific IT applications. However, the currency of DFAT's agency wide BCP arrangements, the existence of gaps in

the testing program and the development of an agency wide DRP linking individual DRPs are areas where improvement is needed. The lack of an up-to-date, fully tested BCP may prevent DFAT from restoring critical business systems within acceptable timeframes in the event there is an interruption to operations. In addition, all critical services and systems may not have been identified in the absence of an agency wide DRP.

Conclusion

4.251 The ANAO found that the majority of DFAT's key internal controls were operating satisfactorily to provide reasonable assurance that the department will be able to produce financial statements free of material misstatement. DFAT has responded positively to the ANAO's findings and associated recommendations and is working to address these issues.

Health and Ageing Portfolio

Department of Health and Ageing

Business operations

4.252 The Department of Health and Ageing's (DoHA) vision is for better health and active ageing for all Australians. DoHA works to achieve this through its policy advice, research and regulations activities, and partnerships with other government agencies, consumers and stakeholders.

4.253 DoHA's Corporate Plan 2006–09 sets out its current key priorities and goals with a view to achieving this vision.

4.254 The priorities for DoHA during 2008–09 include:

- focusing the health and aged care system more on healthy lifestyles, prevention and early intervention and a 'best practice' handling of chronic disease;
- improving the transparency, accessibility, accountability and quality of public and private health and aged care service provision through financing and agreements with stakeholders, industry and State and Territory governments;
- consolidating and progressing reforms to ensure choice and access to quality aged care services;
- working together with the States and Territories to reduce duplication and gaps, and to deliver efficient, value-for-money health and aged care services through an adaptable and sustainable health and aged care workforce;
- working towards improved health for Aboriginal and Torres Strait Islander peoples through whole-of-government arrangements for policy development and service delivery, and improved access to, and responsiveness of, the mainstream health system;
- improving choice for consumers through strong private sector involvement, effectively integrated with the public sector; and

- leading a whole-of-government approach to strengthening Australia’s readiness for disease threats, national emergencies and other large scale health incidents.

4.255 The department’s consolidated financial statements include the Department of Health and Ageing, the Therapeutic Goods Administration (TGA), the National Industrial Chemicals Notification and Assessment Scheme (NICNAS) and the Office of the Gene Technology Regulator (OGTR).

4.256 During 2008–09, DoHA has been impacted by the new framework on federal relations agreed by COAG. Under a new Intergovernmental Agreement there has been a rationalisation of the number of National Specific Purpose Payments and National Partnership payments, with Treasury assuming responsibility for making Commonwealth payments to the States and Territories.

4.257 DoHA’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	587	
Appropriation revenue	574	
Administered income		459
Administered expense		49 730
Total assets	299	763
Total liabilities	212	2710

DoHA’s estimated average staffing level for 2008–09 is 4343

Understanding the environment

4.258 As part of DoHA’s financial statement audit, the ANAO gains an understanding of the agency and its environment, and internal controls. Two of the important factors considered were DoHA’s corporate governance arrangements and financial reporting framework.

Corporate governance

4.259 The key elements of DoHA’s corporate governance that contribute positively to the financial management regime of the department include:

- an executive committee (chaired by the Secretary) that is responsible for the active management and oversight of all major departmental policy, financial and operational decision making;
- a governance committee framework including an Audit Committee. The Audit Committee, that includes two independent members, 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 Audit Committee and the executive committee;
- a risk management framework including Chief Executive Instructions, Procedural Rules, a Risk Management Policy and an Enterprise Risk Management Plan (ERMP). Risks identified in the ERMP are reported quarterly to the Executive Management Committee, Audit Committee and the Risk and Security Committee;
- a fraud control plan that is monitored and reviewed on a cyclical basis in line with the Government's Fraud Control Policy. Fraud risk is considered as part of the ERMP;
- a Certificate of Compliance regime that incorporates semi-annual control self assessments. This regime forms a key part of DoHA's corporate governance and compliance framework and enables managers to survey and report on their understanding of, and compliance with, DoHA's corporate governance and compliance framework; and
- governance arrangements with Medicare Australia to manage the relationship between the two entities regarding administered payments.

Financial reporting framework

4.260 DoHA has a sound financial reporting framework that incorporates key financial and non-financial measures to monitor performance and financial management. Monthly reports are distributed to the executive, division heads and state and territory managers to identify and explain variances between budgeted and actual performance, key drivers of costs and a summary of anticipated events that have an impact on financial performance.

Identifying financial reporting risks

4.261 The ANAO's understanding of DoHA and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.262 The ANAO has assessed the risk of material misstatement in the 2008–09 DoHA financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the significant size of the DoHA's administered payments (\$50 224 million), which include high volume, high value and complex personal benefits expenses and liabilities processed by Medicare Australia, and significant grant and subsidy payments to State and Territory governments and other service providers and program recipients;
- the management of, accounting for and sensitivity of disclosures of some account balances, such as the National Medical Stockpile;
- a complex funding model and appropriation disclosure;
- complex estimation for the reporting for the Government's liabilities under the medical indemnity initiative;
- the administration and management of a large volume of grants to disparate recipients that range in scale and complexity; and
- consolidation of significant departmental business operations in DoHA's financial statements.

Audit results

4.263 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	2	0	0	2	(2)	0	0
Total	2	0	0	2	(2)	0	0

4.264 No significant or moderate findings were noted during the 2008–09 interim audit.

4.265 The 2007–08 final audit of the department reported three moderate risk findings that were carried forward from the 2007–08 interim audit. Two of these related to information technology security and configuration in the department and the other concerned business continuity planning in the Therapeutic Goods Administration (TGA). Our 2008–09 interim audit identified that the department and TGA have taken action to address satisfactorily each of these findings.

Conclusion

4.266 Based on the audit work performed to date, DoHA's key internal controls were operating satisfactorily to provide reasonable assurance that DoHA can produce financial statements free of material misstatement.

Human Services Portfolio

Department of Human Services

Business operations

4.267 The Department of Human Services' (DHS) sole outcome is the effective and efficient delivery of social and health related services, including financial assistance to the Australian community. DHS is responsible for ensuring the Australian Government is able to get best value for money in service delivery while emphasising continuous service improvement and a whole-of-government approach.

4.268 As at 1 July 2008 DHS began an internal restructure to clarify the accountability of the Secretary of DHS for the Child Support Agency (CSA) and CRS Australia as well as the strategic and business-focussed central department. Initially the corporate expertise of the central department and the CSA were brought together with CRS Australia being considered as a second stage. The role of DHS is to direct, coordinate and broker improvements to service delivery. CSA ensures that children of separated parents receive the financial support that both their parents are responsible for providing. CRS Australia assists people who have a disability or injury to return to work and is currently classified as a business operation of the department.

4.269 The following entities report through the Secretary of DHS to the Minister:

- Centrelink;
- Medicare Australia; and
- Australian Hearing.

4.270 DHS's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	497	
Appropriation revenue	504	
Administered income		1195
Administered expense		1346
Total assets	315	585
Total liabilities	166	611

The estimated average staffing level for 2008–09 is 5549.

Understanding the environment

4.271 As part of DHS's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DHS's corporate governance arrangements and financial reporting framework.

Corporate governance

4.272 The key elements of DHS's corporate governance that contribute positively to the financial management regime of the department include:

- an Executive Management Committee that meets weekly to oversee operations and performance and to provide strategic direction;
- committee structures that provide direction in areas such as people and leadership, national operations, risk management, information technology and management, finance and security;
- an audit committee that meets every two months and focuses on matters relating to risk assessment and management, internal audit, external audit, fraud control and financial reporting and is supported by a risk management committee in CRS Australia;
- an internal audit strategy and plan and internal audit program that address key business and financial risks and aims to assist line areas meet their key objectives;
- a strategic level risk management plan for DHS and individual risk management plans across all divisions of the department including CRS Australia; and
- a fraud control plan to identify and manage fraud risks.

Financial reporting framework

4.273 DHS has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor financial management across DHS. Monthly financial reports are considered by the Executive Management Committee and include explanations for variances from budget or expected outcomes and detail any areas that are of special interest to the committee and

divisions. From January 2009 DHS also commenced a process of reporting forecast operating results to the Executive Management Committee.

Identifying financial reporting risks

4.274 The ANAO's understanding of DHS and its environment enable the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.275 The ANAO has assessed the risk of material misstatement in the 2008–09 DHS financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- amalgamation of the FMIS of the core department and the Child Support Agency;
- the potential impact on the information technology general control environment, following CSA's disengagement from the ATO;
- a significant change and reform program, including implementation of Stage 3 of the Child Support Scheme Reforms from 1 July 2008 that affect CSA's information technology systems, business processes and the application of capitalisation principles to system costs;
- the accounting and reporting of administered revenues and expenses through the Child Support Agency Special Account based on financial information from a system primarily designed for child support case management purposes; and
- the complex estimation of child support provision for doubtful debts and employee entitlement provisions.

Audit results

4.276 There were no significant or moderate issues identified during the 2008–09 interim audit or in the prior year.

Conclusion

4.277 Based on audit work performed to date, controls were operating satisfactorily to provide reasonable assurance that DHS can produce financial statements free of material misstatement.

Centrelink

Business operations

4.278 Centrelink was established under the *Commonwealth Services Delivery Agency Act 1997* (CSDA Act) and is the principal service delivery organisation within the Human Services Portfolio, responsible for linking Australian Government welfare services. Centrelink's customers include retired people, families, sole parents, unemployed people, people with disabilities, illnesses or injuries, carers, widows, primary producers, students, young people, Indigenous Australians and those from diverse cultural and linguistic backgrounds. Centrelink operates under a purchaser/provider framework and obtains the majority of its funding on a fee for service basis through business partnership arrangements with policy agencies that purchase Centrelink's services.

4.279 Centrelink's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	610	
Appropriation revenue	610	
Administered income		
Administered expenses		
Total assets	963	
Total liabilities	652	

Centrelink's estimated average staffing level for 2008–09 is 24 450.

Understanding the environment

4.280 As part of Centrelink's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal control

structure. Two of the important factors considered are Centrelink's corporate governance arrangements and financial reporting framework.

Corporate governance

4.281 The key elements of Centrelink's corporate governance that contribute positively to the financial management regime of the agency include:

- the Centrelink executive comprising of the Chief Executive and the senior managers who report directly to him, meet monthly;
- a national business plan detailing how Centrelink's business strategies will be achieved. This business plan is the basis for a range of other plans at the division and branch level;
- an audit committee chaired by an independent member, that provides assurance to the Chief Executive that Centrelink operates with an appropriate financial management framework and complies with established internal controls by reviewing specific matters that arise from the audit process. The audit committee focuses on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes and related controls;
- an internal audit function that undertakes a program of audits covering the main aspects of Centrelink's business. The Centrelink internal audit plan is developed based on the endorsed risk management framework, Centrelink's strategic themes and past audit findings. The internal audit plan is reviewed and approved by the audit committee annually;
- a fraud control action plan that addresses fraud associated with welfare payments (payment fraud), benefits as a result of information held by Centrelink (information fraud) and Centrelink's assets, financial and human resources (administrative fraud);
- a review and monitoring framework that includes an assessment and compliance review of benefit payments; and
- a Business Assurance Framework that provides performance assurance to Centrelink's key stakeholders, including Government, policy agencies and customers.

Financial reporting framework

4.282 Centrelink has a monthly financial reporting regime that includes comparison to budget, variance analysis and commentary. The Budget and Management Accounting Branch prepares financial analysis and commentary on a monthly basis. In addition, Centrelink utilises a balanced scorecard to report on progress against key performance indicators.

Identifying financial reporting risks

4.283 The ANAO's understanding of Centrelink and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.284 The ANAO has assessed the risk of material misstatement in the 2008–09 Centrelink financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- voluntary disclosure by customers in relation to the assessment and payment of personal benefits;
- timely implementation of system changes in an environment of frequent legislative and policy changes in personal benefit programs;
- the complexity and dynamics of the IT environment, particularly relating to developing and managing internal systems for benefit payments; and
- the complexity of the process for the recognition and impairment of internally developed software which represents a significant portion of Centrelink's asset base.

4.285 As part of the risk assessment process, the ANAO considered the impact of the Global Financial Crisis and other events on Centrelink's financial statements and the financial information it provides to the policy agencies. There is no significant impact of this crisis or other events on Centrelink's financial statements except for the increase in operations due to the provision of assistance under the Government's stimulus packages and the response to the natural disasters in both Victoria and Queensland.

Audit results

4.286 The following table provides a summary of the status of prior year issues. No new audit issues were raised by the ANAO in 2008–09.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	3	(1)	0	2	(1)	0	1
Total	3	(1)	0	2	(1)	0	1

Prior year moderate risk matter - Category B

4.287 A moderate control weakness reported at the final phase of the 2007–08 audit relating to users having inappropriate access to update benefit payment data was satisfactorily resolved during the interim phase of the 2008–09 audit.

Delegated limits of authority to waive and write-off debt

4.288 Centrelink debt officers are granted the authority to either waive or write-off debt in its debt management system, DMIS, depending on the customer's circumstances and the authority limits delegated to them by the Chief Executive in accordance with the relevant legislation. Our audit found that the delegation levels configured within the DMIS did not align with the instruments of delegation. Accordingly, debts may be waived and/or written off by officers acting outside their delegated authority. Centrelink has advised that a correction to DMIS has been developed to address this issue.

Conclusion

4.289 The ANAO found that Centrelink's key internal controls were operating satisfactorily. Our interim audit has identified a small number of minor administrative and procedural issues that require management attention. Centrelink has responded positively to the ANAO's findings and associated recommendations.

Medicare Australia

Business operations

4.290 Medicare Australia administers a range of health-related and other programs on behalf of the Australian Government, and plays an integral role in the Australian health sector.

4.291 The objective of Medicare Australia is to work together with its strategic policy partners and stakeholder to improve the health and wellbeing of Australians by delivering information and payment services.

4.292 The key programs Medicare Australia delivers on behalf of the Department of Health and Ageing (DoHA) and the Department of Veterans' Affairs are: Medicare and veterans treatment accounts processing; Pharmaceutical Benefits Scheme (and Repatriation Pharmaceutical Benefits Scheme); Residential Aged Care Subsidies; Australian Organ Donor Register; Australian Childhood Immunisation Register; and Dental Benefits Scheme.

4.293 Medicare Australia also administers a range of programs supporting general practice, including the General Practice Immunisation Incentive Scheme, the Practice Incentives Program, the Rural Retention Program, the General Practice Registrars' Rural Incentive Payment Scheme, and the mental health nurse incentive program.

4.294 Medicare Australia provides payments and information services for Family Assistance (with Centrelink and the Australian Taxation Office) to meet the needs of families and undertakes claims processing and payments on behalf of the Office of Hearing Services and the Health Department of Western Australia.

4.295 Medicare Australia administers health sector rebate and reimbursement schemes, such as the Higher Education Contribution Reimbursement Scheme and the Private Health Insurance Rebate. In addition, Medicare Australia administers the Medical Indemnity Scheme, a number of Specialised Drugs programs, the National Bowel Cancer Screening Register as well as the Special Assistance Program for victims of the Bali bombings in 2002 and 2005, the Tsunami, and London and Egypt bombings.

4.296 Medicare Australia’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	628	
Appropriation revenue	612	
Administered income		0
Administered expense		5
Total assets	316	0
Total liabilities	191	1

Medicare Australia’s estimated average staffing level for 2008–09 is 5352.

Understanding the environment

4.297 As part of Medicare Australia’s financial statement audit, the ANAO gained an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are Medicare Australia’s corporate governance arrangements and financial reporting framework.

Corporate governance

4.298 The key elements of Medicare Australia’s corporate governance that contribute positively to the financial management regime of the agency include:

- a Corporate Management Committee that meets monthly to provide strategic advice to the Chief Executive Officer and is supported by a range of subcommittees covering new policy and, business design, technology, operational performance, finance, people and security;
- a Program Integrity Committee to address strategic issues focusing on protecting the integrity of the programs Medicare Australia administers;
- an Audit Committee, chaired by an independent external member, providing independent assurance and assistance to the Chief Executive Officer in relation to Medicare Australia’s risk, control and compliance framework and its external accountability obligations;

- an internal audit function that has a planned risk based audit coverage of Medicare Australia's activities;
- an annual compliance plan for key programs administered by Medicare Australia; and
- a fraud control program prepared in line with the Commonwealth Fraud Control Guidelines.

Financial reporting framework

4.299 Medicare Australia's financial reporting framework includes monthly reports on departmental revenue and expenses. The reports include explanations for variances from budgeted and expected outcomes and forecasts and provide additional details on specific areas of interest to the executive.

4.300 Medicare Australia also provides regular reports to the agencies on whose behalf it provides services. Given the volume of processing performed on behalf of DoHA, Medicare Australia provides reports to DoHA to reconcile information recorded by both agencies within their financial management systems.

Identifying financial reporting risks

4.301 The ANAO's understanding of Medicare Australia and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.302 The ANAO has assessed the risk of material misstatement in the 2008–09 Medicare Australia financial statements as moderate. The major factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the relationship between Medicare Australia and the agencies to which it provides services;
- reliance on external parties to provide information to support significant financial statement balances such as medical indemnity;
- the complexity of IT general and application controls, in a distributed operating environment, to support significant business operations;

- Medicare Australia’s funding model and control framework that supports the reporting of departmental revenue, including revenue received directly from other agencies;
- the level of compliance activity, in particular for Medicare and Pharmaceutical Benefits Scheme (PBS) payments; and
- prior year audit findings on the accuracy, completeness and disclosure of key financial statement components, such as employee and supplier expense transactions, employee entitlements, property lease transactions, appropriations and the financial statement close process.

Audit results

4.303 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	2	(2)	1	1	(1)	0	0
Total	2	(2)	1	1	(1)	0	0

4.304 No significant or moderate findings were noted during the 2008–09 interim audit.

4.305 One moderate risk finding relating to the financial statement preparation process was reported in the final phase of the 2007–08 audit. During the 2008–09 interim audit, the ANAO observed that Medicare Australia has been proactive in addressing this finding and have implemented processes to resolve the weaknesses previously identified. Accordingly this finding has been downgraded to a C category finding.

Conclusion

4.306 The ANAO found that Medicare Australia’s key internal controls were operating satisfactorily to provide reasonable assurance that Medicare Australia can produce financial statements free of material misstatement.

Immigration and Citizenship Portfolio

Department of Immigration and Citizenship

Business operations

4.307 The Department of Immigration and Citizenship (DIAC) is responsible for enriching Australia through the well managed entry and settlement of people. DIAC's business is managing the permanent and temporary entry of people into Australia, enforcing immigration law, successfully settling migrants and refugees and promoting the benefits of citizenship and cultural diversity.

4.308 DIAC's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	1 241	
Appropriation revenue	1 201	
Administered income		918
Administered expense		510
Total assets	1 157	16
Total liabilities	336	45

DIAC's estimated average staffing level for 2008–09 is 7500.

Understanding the environment

4.309 As part of DIAC's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DIAC's corporate governance arrangements and financial reporting framework.

Corporate governance

4.310 The key elements of DIAC's corporate governance that contribute positively to the financial management regime of the department include:

- an executive committee, which assists the Secretary in setting corporate priorities, prioritisation of funding 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 meets at least bi-monthly, focusing on risk management and internal controls, in particular, over financial systems, accounting processes, audit planning and reporting;
- a financial statement sub-committee that meets regularly, focussing on financial statement issues, risks and deliverables;
- a Governance and Assurance Branch that oversees the audit program, promotes better governance practices and fraud risk management throughout DIAC; and
- a Fraud Control Plan that outlines actions that will be undertaken to strengthen DIAC's fraud control framework and includes, for the first time, an action plan to prepare fraud risk assessments across all programs and administrative areas of DIAC.

Financial reporting framework

4.311 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.

Identifying financial reporting risks

4.312 The ANAO's understanding of DIAC and its environment enables the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed. The ANAO has assessed the risk of material misstatement in DIAC's 2008–09 financial statements as moderate (reduced from high in 2007–08) due to improvements in internal controls over significant accounting processes. Factors giving rise to this assessment include:

- decentralised processing of visa revenue in Australia and overseas locations, supported by multiple systems and involving other Australian Government agencies;
- the scope and complexity of the department's change program to complete the reforms arising from the findings and recommendations of the Palmer and Comrie Reports;
- significant changes in the IT environment as a result of the System for People program and support for existing core IT systems including electronic visas, border entry systems, and the Integrated Client System Environment;
- ongoing complexity of contractual and procurement arrangements; and
- the impact of the global financial crisis on the fair value valuations and provision estimates.

Audit results

4.313 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	1	(1)*	0	0	(0)	0	0
B	11	(4)	0	7	(5)	1	3
Total	12	(5)	0	7	(5)	1	3

* SAP application security issue reassessed from a Category A to a Category B finding.

4.314 The 2008–09 interim audit identified one new moderate risk issue relating to expenditure authorisation processes. In addition, the previous 2007–08 moderate risk issues relating to Offshore Visa Business System Security and Processing Controls and Business Continuity Planning remain partially resolved.

4.315 Five moderate risk issues reported in 2007–08 have been satisfactorily addressed. These related to the Adult Migrant English Programme Quality Assurance, the Validation and Reporting of Business System Transactions and

Balances in the FMIS, Management of the FMIS – SAP, Credit Card Expenditure Processing and SAP Application Security.

Moderate Risk Matters—Category B

New and outstanding moderate audit issues

Expenditure authorisation processes

4.316 A 2007–08 Category C finding relating to weaknesses in the purchase order process has been re-assessed to a moderate risk issue as a result of further weaknesses being noted during the 2008–09 interim audit. These relate to the timeliness in the preparation and approval of purchase orders and insufficient approval documentation relating to spending proposals. These weaknesses expose DIAC to an increased risk of non-compliance with Regulation 9 of the Financial Management and Accountability Regulations and the completeness of commitment information within DIAC’s FMIS for financial statement and budget forecasting purposes.

Offshore Visa Business System Security and Processing Controls

4.317 The ANAO’s review of the offshore visa business system (IRIS) security and processing controls identified improvements in access management practices. DIAC has implemented planned system changes that enhance the overall management of user administration. However, outstanding issues remain over the reporting and monitoring of user access and the currency of the IRIS system security plan.

4.318 The ANAO will review this finding as part of the 2009–10 audit.

Business Continuity Planning

4.319 Deficiencies in business continuity planning (BCP) and Disaster Recovery (DR) arrangements were first identified during the 2002–03 financial statement audit. While DIAC has made substantial progress in addressing the deficiencies originally identified, the 2008–09 interim audit observed that completion of DR testing on all components of the FMIS environment had not been undertaken.

4.320 The ANAO will review progress with the implementation of DR arrangements for the FMIS during the final phase of the 2008–09 audit and BCP arrangements more broadly during the 2009–10 audit.

Resolved moderate audit issues

Adult Migrant English Program Quality Assurance

4.321 The ANAO's previous review of financial controls relating to the Adult Migrant English Program (AMEP) identified weakness in management assurance processes over the validity and accuracy of the information entered by AMEP service providers into DIAC systems.

4.322 During 2008–09, DIAC continued to refine the AMEP quality assurance processes through a program of rolling audits of AMEP providers. In addition, an annual data verification project over AMEP expenditure is undertaken. DIAC's and the ANAO's analysis of the results of the data verification project work completed to April 2009 has confirmed that this issue has been satisfactorily addressed.

Validation and Reporting of Business System Transactions and Balances in the FMIS

4.323 During 2007–08, DIAC allocated significant resources to address weaknesses in the capture and reporting of transactions in business systems and the reporting of these transactions in the FMIS. These weaknesses had resulted in incomplete or invalid transactions being reported in either the financial statements and/or management reports.

4.324 DIAC has now completed a complex process of reconciling all transactions within its business systems to the FMIS. This process highlighted weaknesses with the forfeiture processes for Visitor Visa Bonds, which DIAC intends to address prior to the completion of the 2008–09 financial statements.

Management of the SAP FMIS

4.325 In 2005–06, the ANAO raised a significant audit finding in relation to the robustness of controls within DIAC's FMIS, and in particular the alignment between DIAC's policies and business needs and the internal controls configured in the FMIS, specifically system parameters and settings.

4.326 In the context of DIAC's financial statements, the ANAO is satisfied that this issue is being satisfactorily addressed through DIAC's ongoing implementation of the 'Forward to Standard Roadmap' project. The project includes the replacement of existing customisation and the re-engineering of existing processes to align with standard SAP functionality. The project is significant and is not expected to be finalised until 2010.

Credit Card expenditure processing

4.327 During 2007–08, the ANAO’s review of financial controls over DIAC’s Australian Government Purchasing Cards and Diners Club cards identified weaknesses in acquittal processes. Whilst DIAC has addressed deficiencies relating to automated credit card work flows and credit card clearing accounts, the ANAO continued to identify issues with the credit card acquittal process during the final phase of the 2007–08 audit.

4.328 The ANAO reviewed DIAC’s progress to remediate this issue during the 2008–09 audit and concluded that DIAC has made adequate progress to strengthen the monitoring over credit card acquittals to downgrade the issue to a Category C finding.

FMIS application management – security monitoring

4.329 The 2007–08 interim audit highlighted issues relating to FMIS security that increased the risk of inappropriate access and unauthorised activity not being detected by DIAC. Weaknesses observed included users being granted privileged access without authorisation, the segregation of duties not being managed and a lack of monitoring of system access for a significant period.

4.330 During 2008–09, DIAC has developed and implemented an FMIS security access matrix to address potential segregation of duties issues within the FMIS.

Conclusion

4.331 The ANAO found that the majority of DIAC’s key internal controls tested were operating satisfactorily to provide reasonable assurance that the department can produce financial statements free of material misstatement. Our interim audit has confirmed that DIAC has undertaken significant work to reduce the number of control issues that require management attention, and continues to respond positively to the ANAO’s findings and associated recommendations.

Infrastructure, Transport, Regional Development and Local Government Portfolio

Department of Infrastructure, Transport, Regional Development and Local Government

Business operations

4.332 The Department of Infrastructure, Transport, Regional Development and Local Government (Infrastructure) provides a range of infrastructure, transport, regional development and local government services and information to, and in partnership with, government, industry and the broader community.

4.333 Infrastructure has received significant levels of additional funding as part of the Government's economic fiscal stimulus during the 2008–09 financial year. This additional funding has been largely received for Infrastructure's grants programs which include:

- Nation Building Plan for the Future – investing in Network 1, metro rail and the Bruce Highway duplication (\$1023m);
- Regional and Local Community Infrastructure Program –Standard (\$250m) and Strategic Projects (\$300m), and accelerated Local Government payments (\$480m);
- Bring forward of Investment to build better roads as part of the AusLink Investment program (\$328m);
- Repairing regional links on the national highway network (\$150m);
- Additional Black Spots funding (\$90m);
- Boom Gates for Rail Crossings (\$50m); and
- East Kimberly Development Package (\$16.4m).

4.334 Under revised COAG arrangements, the responsibility for the payment of significant number of grants to the States and Territories will be transferred on a progressive basis to Treasury. As the transfer of responsibility for the payment of most grants has been deferred to 2009–10, the revised arrangement will have limited impact on the department's 2008–09 financial statements.

4.335 Infrastructure’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	246	
Appropriation revenue	243	
Administered income		1 170
Administered expense		8 669
Total assets	156	2 847
Total liabilities	51	6

Infrastructure’s estimated average staffing level for 2008–09 is 1192.

Understanding the environment

4.336 As part of Infrastructure’s financial statement audit, the ANAO gained an understanding of the agency and its environment, including its internal controls. Two of the important factors considered were Infrastructure’s corporate governance arrangements and financial reporting framework.

Corporate governance

4.337 The key elements of Infrastructure’s corporate governance that contribute positively to the financial management regime of the department include:

- an executive management group that meets weekly and addresses strategic issues, monitors Infrastructure’s financial performance, and oversees the operational performance of divisions that includes formal quarterly performance reviews;
- an audit committee that meets regularly and focuses attention on internal controls, management of risks, review of financial reports, control of public monies and regulatory compliance;
- an internal audit function that has a planned risk based audit coverage of Infrastructure’s activities; and
- a fraud control plan that is in the process of being updated and reviewed in line with Commonwealth Fraud Control Guidelines.

Financial reporting framework

4.338 Infrastructure has developed a financial reporting framework that includes monthly reports on both departmental and administered revenue and expenses. The reports include explanations for variances from budgeted or expected outcomes and forecasts and provide additional details on specific areas of interest to the executive.

Identifying financial reporting risks

4.339 The ANAO's understanding of Infrastructure's environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.340 The ANAO has assessed the risk of material misstatement in the 2008–09 Infrastructure financial statements as moderate. The major factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- a considerable increase in grant program activity including new funding agreements as part of the Government stimulus packages;
- short timeframes for the department to establish processes and allocate new grants; and
- the overall magnitude and diversity of grant programs administered by the department.

Audit results

4.341 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	0	0
Total	1	(1)	0	0	0	0	0

4.342 The systems and controls surrounding new grant funding programs established as part of the Government's response to the GFC were in the process of being established by the department at the time of the 2008–09 interim audit. Audit coverage of these programs will be undertaken as part of the 2008–09 final audit.

Conclusion

4.343 Subject to the completion of work around the new grant funding programs, the ANAO found that Infrastructure's key internal controls currently in place were operating satisfactorily to provide reasonable assurance that the department can produce financial statements free of material misstatement.

Innovation, Industry, Science and Research Portfolio

Department of Innovation, Industry, Science and Research

Business operations

4.344 The Department of Innovation, Industry, Science and Research (DIISR) works to boost innovation by Australian industry and improve social and economic benefits for the Australian community by strengthening the links between science, research and industry. DIISR is responsible for developing policies and delivering programs, in partnership with stakeholders, to provide lasting economic benefits ensuring Australia's competitive future.

4.345 On 1 July 2008 the investment promotion function was transferred to Austrade. This transfer resulted from the Administrative Arrangements Order of 3 December 2007, however, the transfer did not take effect until 1 July 2008. A number of locally and overseas based staff have been transferred to Austrade under the new arrangement.

4.346 DIISR's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	284	
Appropriation revenue	284	
Administered income		34
Administered expense		3 605
Total assets	241	2 679
Total liabilities	98	261

DIISR's estimated average staffing level for 2008–09 is 1716.

Understanding the environment

4.347 As part of DIISR's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered in understanding the

environment were DIISR's corporate governance arrangements and financial reporting framework.

Corporate governance

4.348 The key elements of DIISR's corporate governance that contribute positively to the financial management regime of the department include:

- regular meetings of the Secretary and senior managers to discuss key aspects of DIISR activities, including program management;
- 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; and
- an internal audit strategy and plan that examines key business and financial risks and aims to assist line areas to meet their key objectives.

Financial reporting framework

4.349 DIISR has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management of key business areas and programs. Monthly reports are produced promptly and include explanation of variances from budget or expected outcomes and detail areas that are of special interest to the executive.

Identifying financial reporting risks

4.350 The ANAO's understanding of DIISR and its environment enabled the risks of material misstatement in the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.351 The ANAO has assessed the risk of material misstatement in the 2008–09 DIISR's financial statements as moderate. The factors which have contributed to this risk assessment, and on which the financial statement audit is focused, include:

- complex administered programs that include the Automotive Competitiveness and Investment Scheme, and the Textile Clothing & Footwear Strategic Investment Program;

- the maintainance of financial information for both DIISR and the Department of Resources, Energy and Tourism under a Memorandum of Understanding that requires the segregation of two data sets within one Financial Management Information System;
- the effect of the Global Financial Crisis on the valuation of certain financial statement balances;
- complex structures for the management of accounting of the administered capital funding that includes the Innovation Investment Fund and the Pre-seed Fund; and
- the on going integration of functions transferred to DIISR in the prior year as a result of the MOG changes of 3 December 2007.

Audit results

4.352 There were no audit issues of a significant or moderate rating raised by the ANAO in 2008–09 or in the prior year.

Conclusion

4.353 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that DIISR can produce financial statements free of material misstatement.

Prime Minister and Cabinet Portfolio

Department of the Prime Minister and Cabinet

Business operations

4.354 The Department of the Prime Minister and Cabinet's (PM&C) principal function is to provide advice and support to the Prime Minister and the Cabinet and to achieve a coordinated approach to the development and implementation of government policies. PM&C takes a lead role in coordinating relevant portfolios, state and territory governments and other stakeholders to progress the government's objectives. This includes:

- policy advice and coordination including domestic and international affairs, national security, government administration, and intergovernmental relations and communications with state and territory governments;
- coordinating the Council of Australian Governments (COAG) arrangements;
- monitoring, assessing and reporting on the performance of governments in implementing nationally agreed reforms through the COAG Reform council; and
- oversight responsibility for the implementation by all jurisdictions of the infrastructure elements of the Government's Nation Building and Jobs Plan. During 2009 the Office of the Commonwealth Coordinator-General was established within PM&C to carry out this function;

4.355 PM&C also provides a range of administrative and support services including:

- secretariat services to the Prime Minister, the Cabinet Secretary, the parliamentary secretaries, the Cabinet and its committees;
- development and coordination of the government's legislative program;
- provision of a secretariat to the Federal Executive Council;
- coordination and arrangements for government hospitality and official ceremonial occasions;

- coordinating and promoting awards and national symbols;
- managing the allowance and other support arrangements for former Governors-General (the Department of Finance and Deregulation will take over responsibility for the management of superannuation for former Governors-General from 1 July 2009); and
- advice and oversight of the official residences: the Lodge and Kirribilli House; and
- support for the Prime Minister and his family.

4.356 PM&C's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	104	
Appropriation revenue	103	
Administered income		0
Administered expense		11
Total assets	65	43
Total liabilities	25	13

PM&C's estimated average staffing level for 2008–09 is 530.

Understanding the environment

4.357 As part of PM&C's financial statements audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are PM&C's corporate governance arrangements and financial reporting framework.

Corporate governance

4.358 The key elements of PM&C's corporate governance that contribute positively to the financial management regime of the department include:

- a Senior Management Group (SMG) that comprises the Executive Group, the Division Heads, the Executive Coordinators and the National Security Chief Information Officer. The meeting is chaired by the Secretary and discusses key business issues, including business priorities, risks and key commitments for the department;

- an audit committee that meets quarterly and is focused on the appropriateness of PM&C's accountability and control framework and management of risks;
- an internal audit function that plans and conducts its work based on risk assessments of departmental activities and direction from the audit committee; and
- a fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines.

Financial reporting framework

4.359 PM&C has a financial reporting framework that highlights performance against budget at the agency and divisional level for both departmental and administered functions. Reporting measures include an explanation of variances, financial projections for the full year and commentary on significant financial issues and recommendations, where appropriate. In addition, non-financial information is also provided to senior management.

Identifying financial reporting risks

4.360 The ANAO's understanding of PM&C and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.361 The ANAO has assessed the risk of material misstatement in the 2008–09 PM&C financial statements as moderate. The factors that have contributed to the risk assessment, and of particular focus of the financial statements audit, include:

- complexities associated with asset management and the valuation of the official residences;
- complexities associated with the administration, management and reporting requirements for appropriations;
- complexities surrounding the accounting for the wind up of the APEC project, particularly relating to asset disposals; and
- the various factors that influence the valuation of departmental employee liabilities and Administered personal benefits liabilities, which are likely to be impacted by the current economic conditions.

Audit results

4.362 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (from the 2008 interim audit)	Findings resolved (at the time of the 2008 final audit)	New findings (from the 2008 final audit)	Findings outstanding (at the end of the 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (2009 interim audit)	Closing position (at the end of the 2009 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	0	0
Total	1	(1)	0	0	0	0	0

Conclusion

4.363 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that the department will be able to produce financial statements free of material misstatement.

Department of Climate Change

Business operations

4.364 The Department of Climate Change (DCC) leads the development and co-ordination of Australia's climate change policy. It is responsible for policy advice, policy implementation and program delivery in three areas: reducing Australia's greenhouse gas emissions; adapting to the impacts of climate change we cannot avoid; and helping to shape a global solution.

4.365 DCC has one outcome:

The well-being of present and future generations of Australians is improved by contributing to effective national and global responses to climate change through policy advice, negotiations and program delivery.

4.366 In 2008–09, the Australian Government announced measures to address climate change. As a result, a significant focus of activity for DCC is to develop the Carbon Pollution Reduction Scheme (CPRS). The design of the CPRS is aimed at reducing Australia's greenhouse gas emissions. Other activities of DCC include:

- developing other domestic policy in relation to Australia's greenhouse emissions reduction target of 60 per cent below 2000 levels by 2050;

- developing a whole of government policy framework for climate change adaptation and advancement of science based research; and
- influencing the development of international policies and measures by Australia being an active participant in international climate change negotiations to address climate change.

4.367 DCC's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	84	
Appropriation revenue	79	
Administered income		0
Administered expense		42
Total assets	36	0
Total liabilities	22	3

DCC's estimated average staffing level for 2008–09 is 310.

Understanding the environment

4.368 As part of DCC's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DCC's corporate governance arrangements and financial reporting framework.

4.369 Following DCC's establishment in December 2007, the department has made reasonable progress toward implementing key elements of an effective internal control regime, including a corporate governance framework.

Corporate governance

4.370 The key elements of DCC's corporate governance that contribute positively to the financial management regime of the department include:

- an executive board that meets monthly to monitor the department's financial position, staffing demographics and capital expenditure;
- quarterly certificate of compliance reporting by divisions to the legal and governance team that are considered by the audit committee; and

- an audit committee that meets at least quarterly and focuses on DCC's process for managing risks.

4.371 Internal audit is another key element of a good corporate governance structure. In early 2009, DCC engaged an outsourced service provider to undertake DCC's internal audit function. At the time of audit an internal audit strategy plan was being developed that is expected to align DCC's risk assessment and management priorities.

4.372 Section 45 of the FMA Act specifies that Chief Executives must implement a fraud control plan for their agency. DCC has a fraud control plan for the period 1 July 2008 to 30 June 2010 that was approved by the executive in December 2008.

Financial reporting framework

4.373 DCC has implemented a financial reporting process that provides the departmental executive with key financial performance information, promoting effective management of the department. Monthly reports include actual versus budgeted information, projected operating result, details on capital expenditure and an analysis of staff demographics.

Identifying financial reporting risks

4.374 The ANAO's understanding of DCC's and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for the appropriate audit procedures to be designed and performed.

4.375 The ANAO has assessed the risk of material misstatement in the 2008–09 DCC's financial statements as moderate. The factors that have contributed to the risk assessment, include:

- the progressive implementation and refinement of internal controls, including a corporate governance framework; and
- the implementation of a new financial management information system.

Audit results

4.376 There were no audit issues of a significant or moderate rating raised by the ANAO in 2008–09 or in the prior year.

Conclusion

4.377 Based on our audit work performed to date, DCC's key internal controls were operating satisfactorily to provide reasonable assurance that the department can produce financial statements free of material misstatement.

Resources, Energy and Tourism Portfolio

Department of Resources, Energy and Tourism

Business operations

4.378 The Department of Resources, Energy and Tourism (RET) priorities are based on the importance of enhancing Australia's economic prosperity to ensure that Australia maintains its international competitiveness and responds to the increasing globalisation and technology developments of the resources, energy and tourism industries. RET achieves its objectives by providing high quality advice and services to improve the competitiveness and sustainability of the resources, energy and tourism industries. At the same time RET is working to encourage small to medium businesses into these sectors and shared access to the benefits of economic growth.

4.379 RET's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	85	
Appropriation revenue	85	
Administered income		1 909
Administered expense		1 117
Total assets	28	372
Total liabilities	27	40

RET's estimated average staffing level for 2008–09 is 360.

Understanding the environment

4.380 As part of RET's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls.

4.381 RET was created as part of the Machinery of Government changes that took effect on 3 December 2007. As an interim measure, RET entered into an arrangement for the Department of Innovation, Industry, Science and Research

(DIISR) to provide administrative support, including processing payments and providing information for management reporting purposes.

4.382 These arrangements remain in place, and a Memorandum of Understanding between the two departments was finalised in May 2009.

4.383 Two of the important factors considered in understanding the environment were RET's corporate governance arrangements and financial reporting framework.

Corporate governance

4.384 The key elements of RET's corporate governance that contribute positively to the financial management regime of the department include:

- regular meetings of the Secretary and senior managers to discuss key departmental activities;
- development of a fraud risk framework including the development of a fraud control plan and fraud risk assessments;
- an audit committee, with both internal and independent members, which is focused on RET's accountability and control framework; and
- an internal audit function that plans and conducts work based on risk assessments of departmental activities and direction from the Audit Committee.

Financial reporting framework

4.385 RET has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management of key business activities and programs. Monthly reports are produced promptly and include explanation of variances from budget or expected outcomes and detail areas that are of special interest to the executive.

Identifying financial reporting risks

4.386 The ANAO's understanding of RET and its environment enabled the risks of material misstatement in the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.387 The ANAO has assessed the risk of material misstatement in RET's 2008–09 financial statements as moderate. The factors which have contributed to this risk assessment, and on which the financial statement audit is focused, include:

- its reliance on DIISR for the day-to-day processing, recording of financial transactions and maintenance of human resource and financial management information systems; and
- the financial position of RET in light of losses incurred in its first year of operation in 2007–08.

Audit results

4.388 There were no significant or moderate audit issues raised by the ANAO in 2008–09 or in the prior year.

Conclusion

4.389 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that RET can produce financial statements free of material misstatement.

Treasury Portfolio

Department of the Treasury

Business operations

4.390 The Department of the Treasury (the Treasury) is the primary advisory body to the Australian Government on economic policy and development. The Treasury seeks to promote a sound macroeconomic environment; effective government spending arrangements; effective taxation and retirement income arrangements; and well functioning markets, by providing sound and timely advice to the Australian Government and assisting Treasury Ministers in the administration of their responsibilities and the implementation of Government decisions.

4.391 Two factors that have a significant impact on the Treasury's business operations in 2008–09 are the global economic environment and COAG reforms relating to the federal financial relations framework. The Treasury has a lead role in providing analysis and advice to government on managing the impacts of the global financial crisis. It continues to develop policies with the goal to ensure the financial system remains robust and dynamic and that regulatory frameworks promote macroeconomic stability and market confidence. New undertakings for the 2008–09 year include the Treasury's role in monitoring and providing advice in relation to the guarantees of deposits and wholesale funding, and the proposed temporary and voluntary guarantee over state government borrowings. The Treasury is also responsible for implementing and administering the special purpose vehicles that have been announced by the Government to address credit constraints.

4.392 As outlined in Chapter 2, reforms to the federal financial relations framework were agreed by COAG to commence from 1 January 2009. Under the revised framework, payments for specific purposes will be made through combined payments from the Commonwealth Treasury to and through State and Territory treasuries. Transitional arrangements apply to 30 June 2009 and during this period some agencies will continue to make some payments under arrangements agreed with the Treasury. Under the revised arrangements, individual policy agencies will continue to be responsible for the non-financial performance of programs and will periodically advise the Treasury of details

of specific purpose payments and amounts payable under National Partnership agreements.

4.393 These arrangements will result in a change in the way special purpose payments are reflected in the financial statements of the Treasury and the individual Australian Government agencies impacted by the changes.

4.394 The Treasury's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Budget estimate (\$m)	Administered Budget estimate (\$m)
Net cost of services	152	
Appropriation revenue	149	
Administered income		2 566
Administered expense		52 722
Total assets	119	19 084
Total liabilities	48	6 176

The Treasury's estimated average staffing level for 2008–09 is 932.

Understanding the environment

4.395 As part of the Treasury's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered were the Treasury's corporate governance arrangements and financial reporting framework.

Corporate governance

4.396 The key elements of Treasury's corporate governance that contribute positively to the financial management regime of the department include:

- an executive board that meets twice a month and is responsible for high level policy issues relating to the Treasury's strategic leadership and management;
- a committee framework including an audit committee. The audit committee meets at least six times a year and focuses attention on corporate governance, internal audit, external audit, fraud and risks faced by the Treasury;
- an internal assurance function that has a planned risk based coverage of the Department's activities; and

- a periodic fraud risk assessment is undertaken in line with the Commonwealth Fraud Control Guidelines.

Financial reporting framework

4.397 The Treasury has comprehensive and detailed monthly reporting processes, which involve the preparation and distribution within two weeks of month end. Reports are provided to the executive board and outline the departmental and administered financial position and performance by area or group, a capital management report, a variance review of the Treasury's departmental results against the year to date budget, and a quality assurance report.

Identifying financial reporting risks

4.398 The ANAO's understanding of the Treasury and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.399 The ANAO has assessed the risk of material misstatement in the Treasury's 2008–09 financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the impact of the current global economic environment on key financial statement items;
- the impact of managing the transitional arrangements for National Specific Purpose Payments and National Partnership Program payments to the States and Territories as a result of the COAG reforms;
- the accounting treatment and recognition of revenues and liabilities in relation to the Australian Government's deposit and wholesale funding guarantees;
- the impact of the Australian Government's proposed special purpose vehicles for car dealership and commercial property financing arrangements; and
- the administration and management of significant administered grants including GST payments to the States and Territories and the First Home Owners Boost.

Audit results

4.400 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
Total	0	0	0	0	0	1	1

4.401 The 2008–09 audit identified the following issue that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matters—Category B

Employee Processes—Segregation of Duties and Reconciliations

4.402 Treasury performs a number of reconciliations between HR reports and the FMIS to verify the accuracy and completeness of employee financial information. The ANAO identified that many of these reconciliations were not signed and dated as being reviewed and supporting documentation was inadequate.

4.403 The ANAO also observed that employee related transactions were processed into the HRMIS by a single officer without being reviewed.

4.404 A lack of effective reconciliations of employee financial information and no review of transactions entered into the HRMIS, increase the risk that incorrect or fraudulent transactions may occur and not be detected by Treasury.

4.405 Treasury responded positively to this matter and the ANAO noted an improvement in the performance of reconciliations during the conduct of the audit.

Conclusion

4.406 The ANAO found that, with the exception of the abovementioned audit finding, Treasury’s key internal controls relevant to the financial statements

were operating as designed. Audit work continues on the many new measures being undertaken by Treasury in relation to the economic environment.

Australian Office of Financial Management

Business operations

4.407 The Australian Office of Financial Management (AOFM) is responsible for the management of the Australian Government’s debt and financial assets entrusted to it. The AOFM issues Treasury Bonds and Treasury Notes, manages the Government’s cash balances and invests in high quality financial assets including residential mortgage-backed debt securities, term deposits and money market instruments.

4.408 In carrying out its role, the AOFM is responsible for one outcome:

To enhance the Commonwealth’s capacity to manage its net debt portfolio, offering the prospect of savings in debt servicing costs and an improvement in the net worth of the Commonwealth over time.

4.409 AOFM’s estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Budget estimate (\$m)	Administered Budget estimate (\$m)
Net cost of services	7	
Appropriation revenue	8	
Administered income		3 197
Administered expense		4 828
Administered re-measurements - loss		(3 245)
Total assets	17	35 512
Total liabilities	1	111 891

AOFM’s estimated average staffing level for 2008–09 is 31.

Understanding the environment

4.410 As part of the AOFM’s financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are the AOFM’s corporate governance and financial reporting frameworks.

Corporate governance

4.411 The key elements of the AOFM's corporate governance framework that contribute positively to the financial management of the agency include:

- an advisory board accountable to the Secretary to the Treasury that provides general counsel and guidance on all aspects of operational debt policy matters and the performance of the AOFM generally. The Board consists of executive and non-executive members;
- an assets and liability management committee whose primary responsibility is to proactively monitor and assess the financial risks associated with the Commonwealth's portfolio of debt and financial assets;
- an executive committee with responsibility for the oversight of the operational control environment;
- an audit committee that focuses attention on internal audit, external audit, fraud controls and the statutory financial statements;
- an operational risk committee whose role is to monitor the adequacy of internal controls, the prevention of fraud and the identification of operational risks;
- an internal assurance function that has a planned risk based coverage of the AOFM's activities; and
- a fraud control plan that is regularly monitored and reviewed.

Financial reporting framework

4.412 The AOFM has a comprehensive monthly financial reporting process. Full accrual monthly reports are prepared that include actual versus budgeted departmental revenue and expenditure results, variance analysis and commentary. In addition, detailed monthly reporting is undertaken to evaluate the financial results of administered functions. These evaluations include review of the investment portfolio, interest cost projections, liquidity and cash management, long term debt portfolio and credit risks.

Identifying financial reporting risks

4.413 The ANAO's understanding of the AOFM and its control environment has enabled the ANAO to identify and assess the risks of material

misstatement of the AOFM's financial report, and for appropriate audit procedures to be designed and performed.

4.414 The ANAO has assessed the risk of material misstatement in the 2008–09 AOFM financial statements as moderate. The major factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused is the complexity of the reporting requirements for Financial Instruments and the expansion of the AOFM's debt and investment activities during 2008–09.

Audit results

4.415 There were no significant or moderate audit issues raised by the ANAO in 2008–09 or in the prior year.

Conclusion

4.416 Based on audit work to date, internal controls are operating satisfactorily to provide reasonable assurance that the AOFM can produce financial statements free from material misstatements.

Australian Taxation Office

Business operations

4.417 The Australian Taxation Office (ATO) is the Australian Government's principal revenue management agency. In 2008–09, the ATO is expected to collect approximately 90 per cent of the Australian Government's revenue on behalf of the Australian community.

4.418 The ATO business operations include:

- management of Australia's taxation, excise and superannuation systems that fund services for Australians, giving effect to social and economic policy;
- addressing broader issues affecting Australia's revenue system, such as aggressive tax planning, persistent tax debtors, globalisation and the cash economy;
- supporting delivery of community benefits, with roles in other services, including private health insurance, family assistance, fuel grants and benefit schemes;

- cross agency support such as working with: Centrelink to reduce benefit fraud; the Child Support Agency to ensure income transfer for the care of children; and the Australian Bureau of Statistics to reduce the cost to the community of collecting statistical data; and
- overseeing the Australian Valuation Office.

4.419 In addition to optimising revenue collections and making payments under the law, the ATO's priorities for 2008–09 are:

- delivering the Government's agenda in terms of ATO's outcome, outputs and effectiveness;
- differentiating, according to the nature and level of risk, strategies to encourage higher levels of voluntary compliance and to reduce compliance costs;
- tailoring business processes to make the community's experience timely, easier and more personalised;
- promoting and assisting a capable and well-regulated tax profession; and
- maximising opportunities for productivity improvements to ensure an efficient, effective and adaptive organisation.

4.420 The ATO's estimated key financial figures for the year ending 30 June 2009 are:

Key financial figures for 2008–09	Departmental Estimated actual (\$m)	Administered Estimated actual (\$m)
Net cost of services	2 990	
Appropriation revenue	2 910	
Administered income		267 035
Administered expense		20 773
Total assets	907	27 356
Total liabilities	932	7 773

ATO's estimated average staffing level for 2008–09 is 22 035.

Understanding the environment

As part of the ATO's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal

controls. Two of the important factors considered are the ATO's corporate governance arrangements and financial reporting framework.

Corporate governance

4.421 The key elements of the ATO's corporate governance that contribute positively to the financial management regime of the agency include:

- a strategic statement and plan that provides 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;
- an executive board that meets at least monthly and has a formal bi-annual corporate governance assurance process;
- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on risk assessment, fraud control and internal and external audit activities;
- 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;
- a Financial Assurance Branch that assists the Commissioner of Taxation and the Chief Finance Officer in providing a number of 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 structured framework for incorporating risk management into the broader management and business processes including the development of fraud control plans for each of the business service lines; and
- an internal Certificate of Assurance process that aims to better align ATO's changing priorities and business practices and provides assurance on the integrity of revenue management activities.

Financial reporting framework

4.422 The ATO has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management of key business areas. The ATO management reporting

process includes internal financial reports prepared for distribution and discussion at monthly executive meetings. These reports include overall analysis of expenditure, operating performance of business lines, cash and capital positions, budget changes, and workforce information.

4.423 For administered items, a report is prepared for executive meetings at the end of each month analysing the status of various revenue and expense items. The report focuses on cash collections and provides an analysis of actual collections for the month against expectations.

Identifying financial reporting risks

4.424 The ANAO's understanding of the ATO and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

4.425 The ANAO has assessed the risk of material misstatement in the 2008–09 ATO financial statements as high. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- self-assessment by taxpayers in the collection and reporting of taxation revenues;
- the complexity and scale of the IT environment, including the implementation of the Change Program;
- ATO's administered financial statements preparation process which is complex, uses data from a number of business systems and requires significant estimation to be made in calculating the balance of a number of financial statement items; and
- complexities associated with the administration of changing legislative requirements.

Audit results

4.426 The following table provides a summary of the status of prior year issues as well as the 2008–09 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2008 interim audit)	Findings resolved (at the time of 2008 final audit)	New findings (during 2008 final audit)	Findings outstanding (at end of 2008 final audit)	Findings resolved (at the time of 2009 interim audit)	New findings (during 2009 interim audit)	Closing position (at end of 2009 interim audit)
A	1	0	0	1	0	0	1
B	4	(2)	3	5	(2)	4	7
Total	5	(2)	3	6	(2)	4	8

4.427 The 2008–09 audit highlighted the following issues that should be addressed to support the adequacy of internal controls and the reliability of information reported in the financial statements.

Significant Risk Matters—Category A

Security Classification

4.428 During the 2006–07 financial statement audit, the ANAO identified non-compliance with the *Australian Government Protective Security Manual* (PSM). During the 2008–09 interim audit, the ANAO has continued to observe instances where the ATO was not complying with its IT security policy and the requirements of the PSM with respect to the classification, storage and distribution of protected information. Weaknesses in the application of security classifications increase the risk that persons without the appropriate clearance or access rights may have access to protected information and/or information may be inappropriately distributed.

4.429 The PSM allows agency heads to waive security requirements for a defined purpose. The ATO has advised that the Commissioner of Taxation has issued a waiver against certain minimum standards of the PSM and the *Australian Government Information and Communications Technology Security Manual* (ACSI 33). The ATO has set a review date for the waivers which will coincide with a review of the underlying control environment. The ANAO considers that current weaknesses indicate that the ATO is still to achieve the standards required.

4.430 The ATO is making some progress to address a range of security issues with several projects relating to these issues in progress, including the electronic scanning of outgoing emails and the establishment of improved systems for electronic storage of protected information. This work has been informed by an external review of information security in 2008. Until these

initiatives are completed, risks associated with the classification, storage and distribution of protected information remain. The ANAO will continue to review remedial measures being taken by the ATO as part of future audits.

Moderate Risk Matters—Category B

Change Program

4.431 The ATO is in the process of changing its business systems as part of the Easier, Cheaper and More Personalised program known as the Change Program. This program involves the progressive development and release into production of a number of system enhancements relating to various aspects of ATO's business, such as Superannuation and Fringe Benefits Tax (FBT). As part of the 2008–09 interim audit, the ANAO conducted a review of aspects of the FBT system released in April/May 2008. In 2007–08 FBT accounted for some 1.4% (or \$3.9 billion) of total ATO income tax and comprised some 22,634 FBT returns and 12,550 FBT refunds.

4.432 Taxpayer information is processed through various system components which are connected through system interfaces. The effectiveness of controls over the processing of information through these interfaces is essential to completeness and accuracy. The ANAO tested the integrity of the controls around significant FBT system interfaces and identified the following three issues.

- System access: the ANAO has identified several security issues around the management of user access rights and responsibilities. These issues risk the integrity of data, including financial transactional data flowing through the ATO's processing system known as Integrated Core Processing (ICP);
- Reconciliations of system information: an important control is the conduct of reconciliations that provide assurance over the number of transactions received from system interfaces and the transfer of information through the various system components. The ANAO identified that subsequent to moving the FBT Release into production, no reconciliations were undertaken. Reconciliations should be completed on a regular basis, reports should be produced, responsibility for ownership of reports should be identified and details for the responsibility of review of reports should be established. Not performing these processes reduces the ability to determine if FBT information processed, is complete and accurate.

- Testing processes: the ATO has in place a set of standards and guidelines on the use of the 'Quality Centre' testing management tool. This tool provides centralised control to manage and organise all testing activities. The ANAO identified that the ATO had not followed key elements of these standards and guidelines such as fully utilising automated reporting capabilities to generate audit trails of testing activities. Departures from the required testing standards and guidelines increases the risk of inaccurate reporting of testing outcomes, and the integrity of test results.

Mainframe Access – Access Control

4.433 The Resource Access Control Facility (RACF) is a mainframe operating system program that provides access control and audit functionality for ATO's mainframe. This program maintains critical management information that is used to manage and monitor all mainframe users.

4.434 As part of the 2008–09 interim audit, the ANAO conducted a review of the management of mainframe access and identified that RACF contained information that was incorrect, outdated, or incomplete. These weaknesses hinder the ability of security administrators to assign and manage access rights to appropriate users.

Ongoing moderate risk matters from prior years

4.435 Our 2008–09 interim audit identified that reasonable progress is being made to resolve three ongoing moderate risk matters. The status of each of these issues is outlined below.

Financial Management of the Change Program

4.436 The 2007–08 final audit identified control weaknesses with the ATO's Change Program 'Project Server' which is used to record the costs associated with the Change Program.

4.437 As a consequence of this finding, testing in the Change Program finance area was extended as part of the 2007–08 final audit. A number of control weaknesses were identified which increased the risk of inaccurate or incomplete financial data. The ATO has given priority to strengthening these financial management processes. The ANAO will review progress on this matter as part of the 2008–09 final audit.

Errors in processing refunds

4.438 The FMO's require agencies to recognise and disclose all appropriations regardless of whether the relevant amounts are considered to be material.

4.439 The 2007–08 final audit identified that the ATO's disclosure of the amount of incorrect refunds was inaccurate as a result of incorrect classification of refunds repaid within each business system. The ANAO will continue to review progress on this issue during the 2008–09 final audit.

Arrangements with other Australian Government agencies

4.440 The ATO has a number of agreements with other government agencies for the provision and receipt of services. The ANAO has previously identified that some Memoranda of Understanding (MOUs) had expired or were in the process of renegotiation. During the 2008–09 interim audit, the ANAO observed that a process for establishing agreements and reviewing existing agreements has been formulated and is being implemented. However, some agreements have expired and the ATO was still in the process of renegotiating them. The absence of up-to-date agreements increases the risk that the ATO may be receiving poor quality services, and may compromise the accountabilities of each party to the agreement.

Conclusion

4.441 The ANAO found that the majority of the ATO's key internal controls were operating satisfactorily. Our interim audit identified a number of control issues that require management attention to reduce the risk of material misstatement in the ATO's financial statements. The ATO has responded positively to the ANAO's findings and associated recommendations.



Ian McPhee
Auditor-General

Canberra ACT
22 June 2009

Appendices

Appendix 1: Agencies covered by this report³⁵

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 the Environment, Water, Heritage and the Arts

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

Centrelink

Medicare Australia

Department of Immigration and Citizenship

Department of Infrastructure, Transport, Regional Development and Local Government

Department of Innovation, Industry, Science and Research

Department of the Prime Minister and Cabinet

Department of Climate Change

Department of Resources, Energy and Tourism

Department of the Treasury

Australian Office of Financial Management

Australian Taxation Office

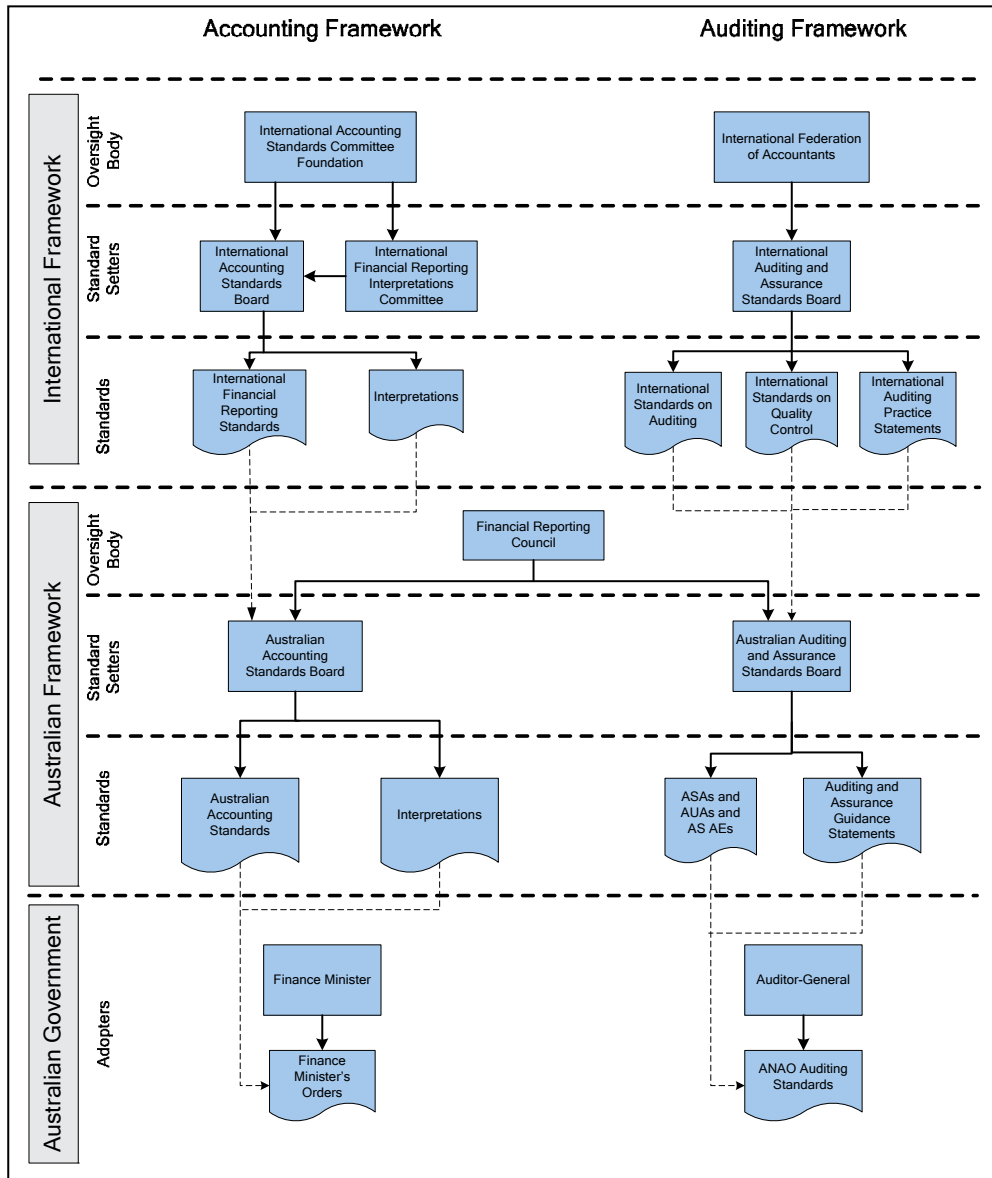
³⁵ Agencies are grouped by portfolio.

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.

Figure A 1

Standard Setting Framework



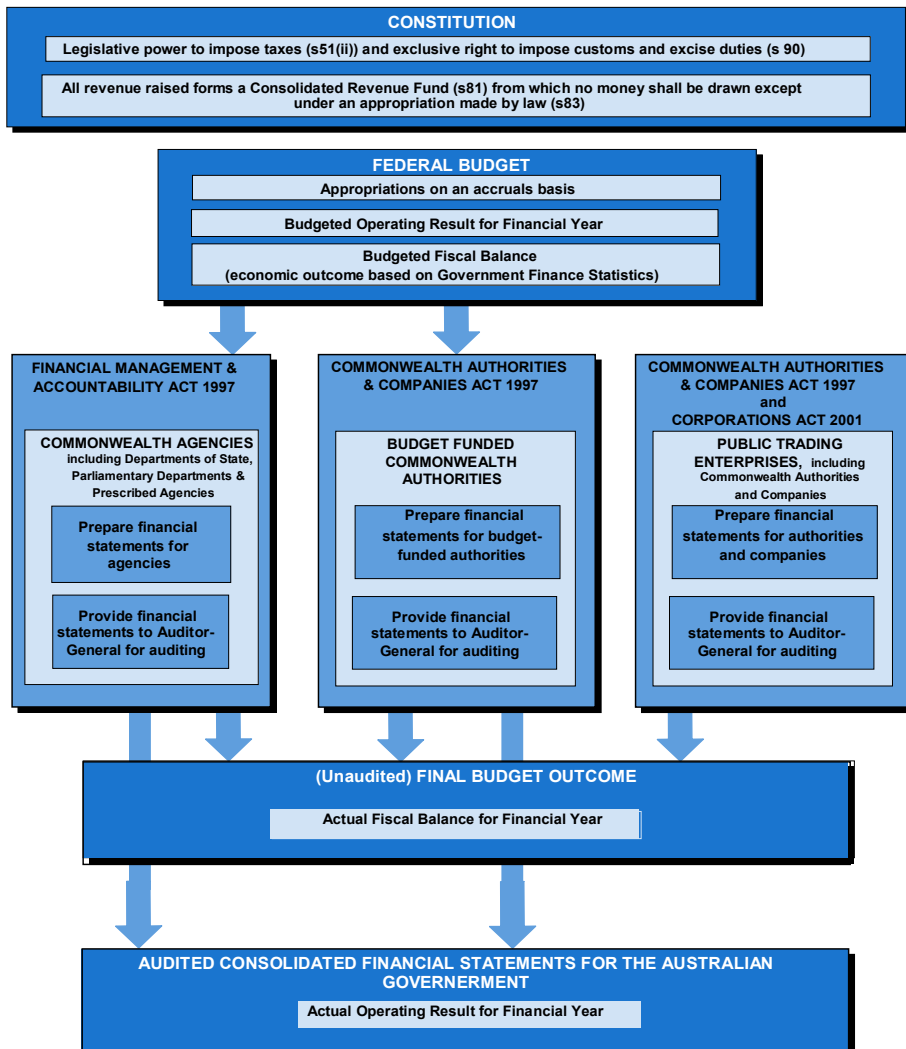
Source: ANAO

Appendix 3: The Financial Reporting Framework

Key elements of the Australian Government’s financial reporting framework is outlined in the diagram below. Then follows an overview of the financial reporting requirements for the various types of Australian Government entities covered by the framework. Finally, the audit of the financial statements of these entities is briefly described.

Figure A 2

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 are subject to the provisions of the FMA Act. They comprise departments of state, parliamentary departments and prescribed agencies.

The FMA Act requires agency Chief Executives to prepare financial statements for their agencies in accordance with FMOs. The FMOs include a requirement that the statements comply with accounting standards issued by the Australian Accounting Standards Board.

Australian Government authorities and subsidiaries

Australian Government authorities are bodies corporate that hold money on their own account and have been created by the Parliament to perform specific functions. Authorities operate under their own enabling legislation and also must comply with relevant provisions of the CAC Act.

The CAC Act requires the governing bodies of authorities to prepare financial statements in accordance with the FMOs. Directors must also ensure that subsidiaries prepare financial statements in accordance with the *Corporations Act 2001* (where applicable) and the CAC Act.

Australian Government companies and subsidiaries

Australian Government companies are companies in which the Australian Government has a controlling interest. Australian Government companies operate and prepare financial statements under the *Corporations Act 2001* and relevant provisions of the CAC Act.

Directors of an Australian Government company must ensure subsidiaries of the company prepare financial statements in accordance with the *Corporations Act 2001* and the CAC Act.

Other bodies

The ANAO also audits the financial statements of other bodies controlled by the Australian Government or where the Australian Government has significant influence. These consist primarily of trusts or joint ventures entered into by Australian Government controlled bodies.

Audit of the financial statements of Australian Government entities

Audit scope

The Chief Executives of agencies, and the directors of authorities and companies, are responsible for the truth and fairness of the financial statements and for the records, controls, procedures and organisation that support the preparation of those statements.

The ANAO conducts independent audits of these financial statements to form an opinion whether, in all material respects, the statements are true and fair. The audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards (ASAs). The objective of an audit of an entity's financial statements is to form an opinion on whether the financial statements, in all material respects is in accordance with the Australian Government financial reporting framework. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial report taken as a whole.

Audit procedures include examination of an entity's records and its control environment, risk assessment processes, information systems, control activities and statutory disclosure requirements. Evidence supporting the amounts and other information in the statements is examined on a test basis, and accounting policies and significant accounting estimates are evaluated.

While entity control structures are evaluated as an integral part of the audit process, only those systems and controls, on which it is intended to place reliance for the purpose of determining audit procedures leading to audit opinions on the financial statements, are evaluated in detail. In some audits, audit procedures concentrate primarily on substantiating the amounts appearing in the financial statements and do not include a detailed 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, are free from material misstatement, whether due to fraud or error.

The auditor's report on financial statements

The auditor's report on the financial statements includes a statement of the auditor's opinion as to whether the statements give a true and fair view of the entity's financial position, the results of its financial operations and its cash flows in accordance with Australian Accounting Standards and other statutory requirements, including the Finance Ministers Orders (FMOs).

If the auditor is not satisfied the financial statements are true and fair, the audit opinion is qualified, with the reasons being indicated. Audit reports may be qualified because of a disagreement between the auditor and management of the entity on the application of accounting standards or other reporting requirements, because the scope of the audit work needed to form an opinion has been limited in some way, or if there is a conflict between the requirements of the Accounting Standards and the FMOs.

An audit report may contain an 'emphasis of matter' to draw attention to a matter that is relevant to the readers of the financial statements. An 'emphasis of matter' does not qualify the audit opinion being given. In many cases, an 'emphasis of matter' relates to inherent uncertainty about an aspect of the financial statements, where the outcome is contingent upon future events, and the effects of the matter are not capable of reasonable measurement at the date the audit report is signed.

The auditor's report may also report on 'other matters'. For example, Section 57 of the FMA Act requires that, in reporting to Ministers on the financial statements of agencies, the Auditor-General must report particulars where, in the Auditor-General's opinion, there has been a contravention of the requirement in section 48 of the FMA Act for agencies to keep proper accounts and records.

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