

The Auditor-General  
Audit Report No.50 2009–10  
Financial Statement Audit

**Interim Phase of the Audit of Financial  
Statements of Major General Government  
Sector Agencies for the year ending  
30 June 2010**

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Canberra ACT  
24 June 2010

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 2009–10 financial statements in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of these audits, related matters and the accompanying brochure, to the Parliament. The report is titled *Interim Phase of the Audit of Financial Statements of Major General Government Sector Agencies for the year ending 30 June 2010*.

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

Yours sincerely

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

Ian McPhee  
Auditor-General

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

## AUDITING FOR AUSTRALIA

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

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# Acronyms

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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	<i>Commonwealth Authorities and Companies Act 1997</i>
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
DCCEE	Department of Climate Change and Energy Efficiency
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

DHS	Department of Human Services
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	<i>Financial Management and Accountability Act 1997</i>
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 the Treasury

# Glossary

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Confidentiality	Information is observed by, or disclosed to, only those who have a right to know.
Control activities	The policies and procedures that help to ensure that management directives are carried out. Control activities are a component of internal control.
Control environment	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 is a component of internal control.
Data Integrity	Information is protected against unauthorised modification or error so accuracy, completeness and validity are maintained.
Governance	The role of the person(s) or organisations with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.
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.
Stakeholder	A person or a party who has either a responsibility for, a legitimate interest in, or an expectation from the agency.
System availability	Information systems are available and usable when required, and can appropriately resist attacks and recover from failures.

# Foreword

---

This report is designed to provide assurance to the Parliament that the systems, controls and processes that are in place in Australian Government agencies<sup>1</sup> are operating in a way that allows agencies to prepare financial statements that give a true and fair view of their financial performance and position at year end.

The report outlines the results of the interim audit coverage of key financial systems and controls in 26 agencies that represent some 95 per cent of total General Government Sector<sup>2</sup> (GGS) revenues and expenses. The audit coverage undertaken forms an integral part of our audit of the 2009–10 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.

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 2009–10 financial statement audits reflect a continuation of the reduction over recent years in the number of significant and moderate risk audit findings. This reflects the general stability and maturity of the control regimes in the majority of agencies and actions taken by agencies to address prior year audit findings.

Our audits do, however, continue to identify control weaknesses in a number of areas particularly relating to agencies' IT control environments, business continuity management and the management of assets.

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

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<sup>1</sup> The term 'agencies' refers to all organisations subject to the *Financial Management and Accountability Act 1997* (FMA Act). As the organisations covered by this report are 'agencies', this term is used predominantly in the report.

<sup>2</sup> The General Government Sector (GGS) comprises all government agencies and other entities that provide largely non-market public services and are funded primarily through taxes 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.

Audit Committees have an important role in agencies' governance arrangements. As part of our 2009–10 interim audits, the ANAO undertook an analysis of audit committee arrangements, responsibilities and membership. Of particular note is the fact that all agency committees include one or more independent members, with 50 per cent of committees having an independent chair. It is also encouraging that a number of agencies have established financial statement sub-committees to assist the audit committee in the oversight of the agency's financial statements.

While the financial reporting framework remained relatively stable in 2009–10, the Australian Accounting Standards Board (AASB) has developed a timetable for review of standards relevant to the public sector and has commenced a post-implementation review of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. The recent introduction of a differential reporting regime by AASB is also a significant development. This regime provides the opportunity for certain classes of entities to be exempt from providing some of the disclosures currently required by the Australian Accounting Standards. Most public sector entities are eligible to participate in the regime, subject to the agreement of their controlling government.

Other changes to the financial framework in future years are expected to arise from: the conceptual framework projects being undertaken by the International Accounting Standards Board (IASB) and the International Public Sector Accounting Standards Board; and an increase in standard-setting activity by the IASB.

In line with a major project by the International Auditing and Assurance Board to improve the clarity of International Auditing Standards, the Australian Auditing Standards have been revised and redrafted in 'clarity format' for reporting periods beginning on or after 1 January 2010. The ANAO's financial statements audit methodology and associated policies are being updated to reflect the revised standards, and financial statement audit staff are being trained in the new requirements.

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.

The ANAO's audit processes include assisting agencies to better manage their responsibilities. In June 2009, the ANAO published two Better Practice Guides, *Planning and Approval of Projects – an Executive Perspective*, and *Better Practice Grants Administration*. A further Guide, *Strategic and Operational Management of Assets by Public Sector Entities* is due to be released shortly. Better Practice Guides are well received by agencies and contribute to agencies maintaining the maturity of their internal control systems.

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 2009–10 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

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## 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. The ANAO's examination of these areas is designed to assess the reliance that can be placed on agency internal controls to produce complete and accurate information for financial reporting purposes.
3. This report presents the results of the interim phase of the 2009–10 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 accounting and auditing requirements and, in doing so, provides an overview of changes impacting on the Australian Government's reporting and accountability frameworks.
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 also includes a discussion of audit findings over the period 2006–07 to 2009–10.
7. Findings relating to the audit of Information Technology (IT) systems focusing on the IT control environment, IT security, 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 that influence financial statement audit coverage; governance arrangements relevant to the agency's financial statements; areas of audit focus, and significant and moderate risk issues identified by our 2009–10 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 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*. The key elements of internal control, as discussed in ASA 315, are the control environment; the risk assessment process; 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 2010. Consistent with past practice, a second report will be tabled in the Parliament in December 2010 following completion of the financial statement audits of all entities for 2009–10. 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' and 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. 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.

### **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, overseen by audit committees or other committees with specific risk management responsibilities.

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 review, update or test their Business Continuity Plans (BCPs) as part of normal business practice. In relation to fraud control, all agencies have in place fraud control plans prepared in accordance with the *Commonwealth Fraud Control Guidelines*. Consistent with our observations in previous years, a small number of agencies needed to improve mechanisms for assessing the effectiveness of their fraud 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 2009–10 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 elements of agencies' IT control environments during 2009–10, particularly in respect of IT security management controls such as security awareness and training, and security monitoring and reporting practices. However, there was a decline in the

effectiveness of incident and problem management controls and a number of agencies would benefit from improving their change management policy and governance frameworks.

19. Consistent with previous years' findings, our audits have continued to identify the need for a number of agencies to improve the management of user access to their Financial Management and Human Resource Management Information systems.

## **Control activities**

20. The results of the 2009–10 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; and the processing of payments. A total of 188 Category A, B and C findings were identified from our 2009–10 interim audits, a significant reduction compared with the 280 findings identified in 2008–09.

## **Monitoring of controls**

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

## **Summary of audit results**

22. As previously indicated, 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.

23. A summary of the trend in Category A and B audit findings between 2008–09 and 2009–10 is outlined below:

- there were three agencies with Category A audit findings in 2009–10 and two agencies in 2008–09;

- the total number of Category A audit findings in 2009–10 is three, the same number as in 2008–09;
  - the total number of Category B audit findings across all agencies decreased from 65 in 2008–09 to 52 in 2009–10; and
  - there was a decrease in the number of Category B audit findings in eight agencies; six showed an increase; the number of Category B audit findings in three agencies remained the same as in 2008–09; and nine agencies had no Category B findings in either 2008–09 or 2009–10.
24. A summary of Category A and B audit findings by agency is provided in Table 4.1 in Chapter 4.



# 1. Financial Reporting and Auditing Frameworks

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*This chapter provides commentary on recent developments in the financial reporting and auditing frameworks relevant to the Australian Government and its reporting entities. 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)<sup>3</sup>. This framework is designed to meet the decision-making and accountability needs of the Government and the Parliament.

**1.2** This chapter outlines progress being made by the AASB in relation to the continuing improvement of public sector financial reporting. Matters addressed include: applying the principles in AASB 1049 *Whole of Government and General Government Sector Financial Reporting* to the financial reports of entities in the General Government Sector; executive remuneration disclosure; accounting for grants; defining the reporting entity; and exempting not-for-profit public sector entities from the requirement to include borrowing costs in the cost of assets under construction.

**1.3** The chapter also discusses other changes to the Australian financial reporting framework that will affect the public sector. These include changes in the format and content of the income statement, enhanced disclosure of financial instruments, reductions in disclosure requirements under the proposed differential financial reporting regime and the convergence of Australian and New Zealand accounting standards.

**1.4** Complementing the financial reporting framework for public sector entities, the ANAO's auditing framework is based on the standards made by the Australian Auditing and Assurance Standards Board (AUASB). This chapter outlines the implementation of recent changes made to Australian Auditing Standards by the AUASB to enhance their quality and maintain uniformity with International Auditing Standards.

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<sup>3</sup> Since 1 January 2009 I have been a member of the Australian Accounting Standards Board.

## Developments in the public sector reporting framework

### AASB review of its public sector-specific standards

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

1.6 The AASB has commenced a post-implementation review of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, which applied for the first time in 2008–09. The focus of the review is on the implementation experience at an operational level, rather than a fundamental review of the standard. The AASB aims to complete the review and issue any resulting amendments by the end of 2010.

1.7 The possibility of applying the principles in AASB 1049 to the financial reports of entities within the General Government Sector (GGS) has been further considered by the AASB, which is now contemplating broader changes to enhance, and improve the comparability of, reporting by these entities. The AASB has decided to issue an exposure draft that would include the following proposed requirements:

- (a) entities to recognise and measure assets in accordance with the Government Finance Statistics (GFS) manual of the Australian Bureau of Statistics, where a choice is permitted by other Australian Accounting Standards;
- (b) information to be disclosed in the notes that combines amounts controlled by entities with those they administer on behalf of government;
- (c) disclosure of budgetary information; and
- (d) a period of three years between the issue of any Standard and when it becomes mandatory.

1.8 The AASB is also considering requirements for not-for-profit public sector entities in relation to related party disclosures, which includes disclosure of executive remuneration. The Australian Accounting Standard on related party disclosures currently applies only to the private and for-profit sectors. The AASB plans to issue an exposure draft of a new standard in late 2010.

1.9 In conjunction with the New Zealand Financial Reporting Standards Board (NZ FRSB), the AASB is considering the accounting treatment of grants.

It is exploring an approach that would defer recognising income from grants until the grant recipient met the enforceable obligations in the grant agreement.

**1.10** The AASB has also commenced a project on the definition of reporting entity in the public sector. This is an important project addressing which entities should prepare financial reports, which entities should be grouped together to produce consolidated reports, and how entities should report items that they administer on behalf of government.

**1.11** For 2009–10, the AASB decided to exempt public sector not-for-profit entities from the requirement of AASB 123 *Borrowing Costs* to capitalise borrowing costs related to assets that necessarily take a substantial period of time to get ready for sale or use. Public sector not-for-profit entities can continue to expense borrowing costs. The AASB will review this exemption at a later date.

### **New statement of comprehensive income**

**1.12** In 2009–10, the AASB released a new version of the accounting standard that prescribes the format of financial statements, AASB 101 *Presentation of Financial Statements*, with effect from 2009–10. Entities are now required to produce a statement of comprehensive income, either as an addition to the existing income statement or as single statement incorporating the information currently presented in the income statement. The Finance Ministers Orders for 2009–10 prescribe the single statement format.

**1.13** Prior to 2009–10, Australian Government entities presented an income statement which excluded some unrealised gains and losses. For example, most revaluations of property, plant and equipment were excluded from the income statement. As a result of the changes to AASB 101, from 2009–10 Australian Government entities will present a single statement of comprehensive income that will include all items of income and expense, including unrealised gains and losses previously excluded from the income statement.

## **Enhanced fair value disclosures**

**1.14** From 2009–10, accounting standards prescribe enhanced disclosure of how entities have calculated the reported fair values of their financial instruments<sup>4</sup>. This change reflects international concerns about financial instruments disclosure in the lead up to the global financial crisis.

**1.15** Entities that carry financial instruments on their balance sheet at fair value will need to classify those instruments into three categories, reflecting the level of objective information used in determining their fair values. This requirement will reveal the extent to which entities have used management assumptions, rather than more objective market information, in calculating fair values. Where entities have primarily relied on management assumptions, further disclosures are prescribed.

**1.16** This change will be an area of focus for the ANAO in the financial statements audits of entities that carry financial instruments on their balance sheet at fair value.

## **Differential financial reporting – reducing disclosure requirements**

**1.17** In July 2009, in recognition of the burden on some entities of complying with accounting standards, the IASB released International Financial Reporting Standards for Small and Medium Sized Entities (IFRS for SMEs). These standards were intended for use by for-profit entities that do not raise capital in public markets nor hold assets in a fiduciary capacity. The practice of having different reporting requirements for different classes of entities is referred to as differential financial reporting.

**1.18** The AASB has decided that differential financial reporting is appropriate for Australia, but has decided not to adopt IFRS for SMEs. Instead, the AASB has released a consultation paper and exposure draft proposing a two-tiered financial reporting regime for Australia. Entities in the first tier would prepare financial statements in accordance with the full suite of Australian accounting standards. Entities in the second tier would prepare similar financial statements, but with substantially reduced disclosure requirements.

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<sup>4</sup> See AASB 7 *Financial Instruments: Disclosure*, paragraphs 27A and 27B



**1.19** For the not-for-profit public sector, the AASB is proposing that federal, state and territory governments will be in the first tier. Entities controlled by these governments and universities could opt for either tier, subject to the requirements of any regulators. In the Australian Government's case, the Finance Minister would determine<sup>5</sup> the policy for entities controlled by the Australian Government; that is, which entities, if any, would be required to present financial statements in accordance with the full suite of Australian Accounting Standards.

**1.20** The AASB proposals would provide an opportunity to reduce the administrative workload of some Australian Government entities, whilst preserving sufficient disclosures to satisfy the needs of the Parliament. The AASB intends to implement the differential reporting regime in time for the preparation of 2009–10 financial statements.

### **Conceptual frameworks for accounting standards**

**1.21** 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.

**1.22** 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.

**1.23** The project is progressing in eight phases. So far, exposure drafts have been issued for two of the phases: the objectives and qualitative characteristics of financial reporting; and the reporting entity concept.

**1.24** The project's primary focus is on for-profit entities. It is only in the latter stages of the project that the applicability of the framework to other entities will be considered. Consequently, the International Public Sector Accounting Standards Board (IPSASB), in conjunction with the AASB and

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<sup>5</sup> The Finance Minister issues orders for financial reporting under the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*. However, these orders do not apply to Commonwealth companies.

other national accounting standards boards, has embarked on a separate project for developing a Public Sector Conceptual Framework. IPSASB has so far released a consultation paper addressing: the objectives and scope of financial reporting; the qualitative characteristics of financial information; and the nature of the reporting entity.

## **Long term fiscal sustainability reporting**

**1.25** In the wake of the global financial crises, and increased borrowing governments world-wide, the IPSASB is considering how information about the long-term fiscal sustainability could be incorporated into governments' financial statements. In Australia, intergenerational reports are already issued every five years by the Treasury to assess the fiscal sustainability of Australian Government policies over a 40 year time horizon, although this information is not included in audited financial statements.

**1.26** The IPSASB has sought comments on its preliminary view that information about long-term fiscal sustainability should be included in governments' financial statements, either in the form of additional statements or summarised projections in narrative reporting, with the key assumptions underlying projections also being disclosed.

## **Australian-New Zealand convergence**

**1.27** Following an agreement between the Australian and New Zealand governments to promote single market outcomes between the two countries, the AASB and NZ FRSB are acting to remove differences between their respective suites of accounting standards. Although the initial focus will be on accounting standards for the for-profit sector, consideration will be given to developing a joint exposure draft to remove existing not-for-profit differences.

**1.28** The AASB and the NZ FRSB have agreed a joint process for considering further changes to accounting standards to reflect the needs of not-for-profit entities.

## **Developments in auditing standards**

**1.29** 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. The ANAO Auditing Standards establish mandatory requirements and provide explanatory guidance for persons performing the functions specified

in section 24, which include the statutory audits of the financial statements of Commonwealth bodies.

**1.30** The ANAO Auditing Standards incorporate, by reference, the current versions of standards set by the AUASB including those for the auditing of financial statements ('Australian Auditing Standards' or 'ASAs'). As a result, financial statement audits conducted by the ANAO are bound by the same standards that apply to the broader auditing profession in Australia.

**1.31** The Auditor-General issued the current ANAO Auditing Standards on 25 June 2009.

**1.32** 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).

**1.33** Previous reports have detailed the completion of the IAASB Clarity Project, a comprehensive program to enhance the quality and uniformity of International Auditing Standards and to encourage greater consistency in their application worldwide. The revised and redrafted ISAs in 'clarity format' were released in 2009.

**1.34** In line with the strategic direction provided by the IAASB, the AUASB revised and redrafted the ASAs using the equivalent ISA as the underlying standard. The AUASB has indicated that the revised Australian standards will continue to conform to ISAs while maintaining enforceability under Australian regulatory arrangements e.g. the *Corporations Act 2001*. The revised standards were approved in October 2009 and are operative for audits of financial statements in Australia for periods beginning on or after 1 January 2010. The ANAO's financial statements audit methodology and associated policies are being updated to comply with the re-issued standards. Further, financial audit staff are receiving training in the new requirements. This opportunity has also enabled the ANAO to review the efficiency of its financial statement audit processes so that it can continue to deliver cost-effective audit services.

**1.35** In addition to redrafting and revising the existing ASAs, the AUASB issued four new auditing standards, including ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements*. Systems of quality control in

compliance with this standard were required to be established by 1 January 2010.

**1.36** The ANAO's Quality Assurance Framework is structured to ensure compliance with relevant regulatory and legal requirements and applicable professional standards, including APES 320 *Quality Control for Firms*, an Australian quality control standard set by the Accounting Professional and Ethical Standards Board (APESB).

**1.37** The revisions to the Australian Auditing Standards have led to a significant increase in the number of mandatory requirements. While much of this increase represents the elevation of guidance material to the status of requirement, this will nevertheless result in an increase in audit costs, which is expected to be proportionately greater for smaller audits.

## Reporting compliance with the Government's financial management framework

### ANAO auditing of compliance

**1.38** The ANAO continues to focus on legislative compliance as part of its financial statement audit coverage. Annual and special appropriations, appropriations of relevant agency receipts, special accounts and the investment of public monies are examined using targeted audit work programs.

**1.39** The ANAO's annual performance audit work program also includes a compliance element, usually with the inclusion of audits that continue the ANAO's examination of aspects of the Australian Government's financial framework. Audit Report No. 14 2009-2010 *Agencies' Contract Management* was tabled 25 November 2009. An audit on *Fraud Control in Australian Government Agencies* was tabled on 27 May 2010. An audit of entities' compliance with the direct source procurement provisions of the Commonwealth Procurement Guidelines is expected to be tabled shortly and an audit on Management of the Certificate of Compliance Process in FMA Act Agencies is currently underway.

## Conclusion

**1.40** Ongoing developments in accounting and auditing frameworks and standards continue to have an impact on the financial reporting responsibilities of public sector entities. The ANAO continues to devote significant resources to the implementation of revised auditing and accounting requirements.

The key drivers of change in the financial reporting and auditing frameworks are expected to be: responses by accounting standard-setters to the global financial crisis; moves to reduce compliance burdens; the increasing convergence of accounting standards; the introduction of new auditing standards; and the AASB's ongoing agenda for public sector financial reporting.



## 2. Summary of Audit Findings and Related Issues

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*This chapter provides a summary of the ANAO's review of internal controls as part of the audit of the financial statements of major agencies. It also provides a short overview of some trends in audit committee arrangements of major agencies.*

### Introduction

**2.1** The Chief Executives of General Government Sector 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.<sup>6</sup> For large entities, the audit is conducted in two main phases—interim and final. The interim phase focuses on an assessment of agencies' key internal controls; in the final audit phase the ANAO completes its assessment of the effectiveness of key controls for the full year, substantively tests material balances and disclosures in the financial statements, and finalises its opinion on the agencies' financial statements. This report focuses on the results of the interim audit phase of the 2009–10 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.<sup>7</sup> While there is no equivalent legislative provision applying to CAC 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.<sup>8</sup>

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<sup>6</sup> *Financial Management and Accountability Act 1997*, section 49 and *Commonwealth Authorities and Companies Act 1997*, sections 9, 12, 36 and 37.

<sup>7</sup> *Financial Management and Accountability Act 1997*, section 44.

<sup>8</sup> *Financial Management and Accountability Act 1997*, section 49.

**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 whether the financial statements, in all material<sup>9</sup> respects, are in accordance with the Australian Government financial reporting framework.<sup>10</sup> In planning the audit, audit procedures are designed to achieve reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial report taken as a whole.<sup>11</sup>

**2.4** 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 misstatement 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 agency'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. The auditor's understanding of the agency, its environment and its internal controls, helps the auditor design the work needed and respond to significant risks.<sup>12</sup> Broad areas of audit focus determined as a result of this planning approach are discussed in Chapter 4 in relation to each agency covered by this report.

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<sup>9</sup> 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.

<sup>10</sup> The key elements of this framework are set out in Appendix 2.

<sup>11</sup> Australian Auditing Standard *ASA 200 Objective and General Principles Governing an Audit of a Financial Report*, paragraph 35.

<sup>12</sup> Significant risks are those risks of material misstatement of the financial statements that, in the auditor's judgement, require special audit consideration.



**2.5** 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 are performed to ensure that the risk accepted is low. These procedures include, for example, obtaining knowledge of the entity and its environment, reviewing the operation of internal controls, undertaking analytical reviews, testing a sample of transactions and account balances, and confirming year-end balances with third parties.

## Internal control

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

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

**2.7** This Chapter discusses each of these elements and outlines our observations in relation to each one, based on our review of relevant aspects of each agency's control environment and the results of our interim audits. As such it includes, where relevant, summary comments on Category A, B and C audit findings.<sup>13</sup>

## Control environment

**2.8** The control environment directly influences the way entities undertake their business and operations. An entity's business and operations influence

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<sup>13</sup> Category A findings are significant audit issues. Category B findings are moderate audit issues, and Category C findings are minor audit issues. These categories are defined in Chapter 4, page 84.

the control environment, which needs to be carefully reviewed as part of the audit process when assessing the risk of material misstatement in financial systems and reports. ASA 315 at paragraph A69 states:

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

**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 financial 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** Agencies have senior management arrangements in place to provide direction, guidance and control over the financial management of their organisations. Executive management committees met regularly to plan and monitor strategic direction and performance. Agencies generally 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. Chief Executives, their senior management group, and audit or risk committees continued to give attention to financial management and audit matters, risk management and performance outcomes.

**2.12** All agencies 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. Further commentary on audit committee responsibilities, membership and meeting arrangements is provided later in this Chapter.

**2.13** The ANAO observed that generally agencies periodically review 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.

**2.14** 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**

**2.15** 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.

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

**2.17** 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.

**2.18** The ANAO is currently undertaking a performance audit of the management of the Certificate of Compliance Process in FMA Act agencies that is expected to be completed in late 2010.

### *Observations*

**2.19** The 2009–10 interim audits identified that, generally, 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** 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 Chief Executive's Instructions, corporate plans, fraud control plans and delegations, as well as conducting targeted training or induction courses.

## Audit committees

**2.22** The important role of audit committees in the public sector is reflected in the requirement for all FMA and CAC entities to establish an audit committee. This legislative requirement has been in force for some 12 years, and audit committees are now a well established and integrated element of the governance arrangements of all public sector entities.

**2.23** As part of the interim phase of our 2009–10 financial statement audits of major agencies, the ANAO undertook an analysis of the responsibilities and composition of audit committees and committee arrangements for the 26 agencies covered by this report.

### Audit committee responsibilities

**2.24** Audit committees generally have responsibility for a range of matters, reflecting the important role they play in assisting the Chief Executive in managing his/her agency.

**2.25** Commonly, audit committees are responsible for overseeing:

- the risk management framework;
- the internal control environment;
- the internal audit function;
- the preparation of the annual financial statements;
- legislative compliance including the Certificate of Compliance process; and
- agency responses to ANAO audit findings and the implementation of recommendations arising from ANAO audits.

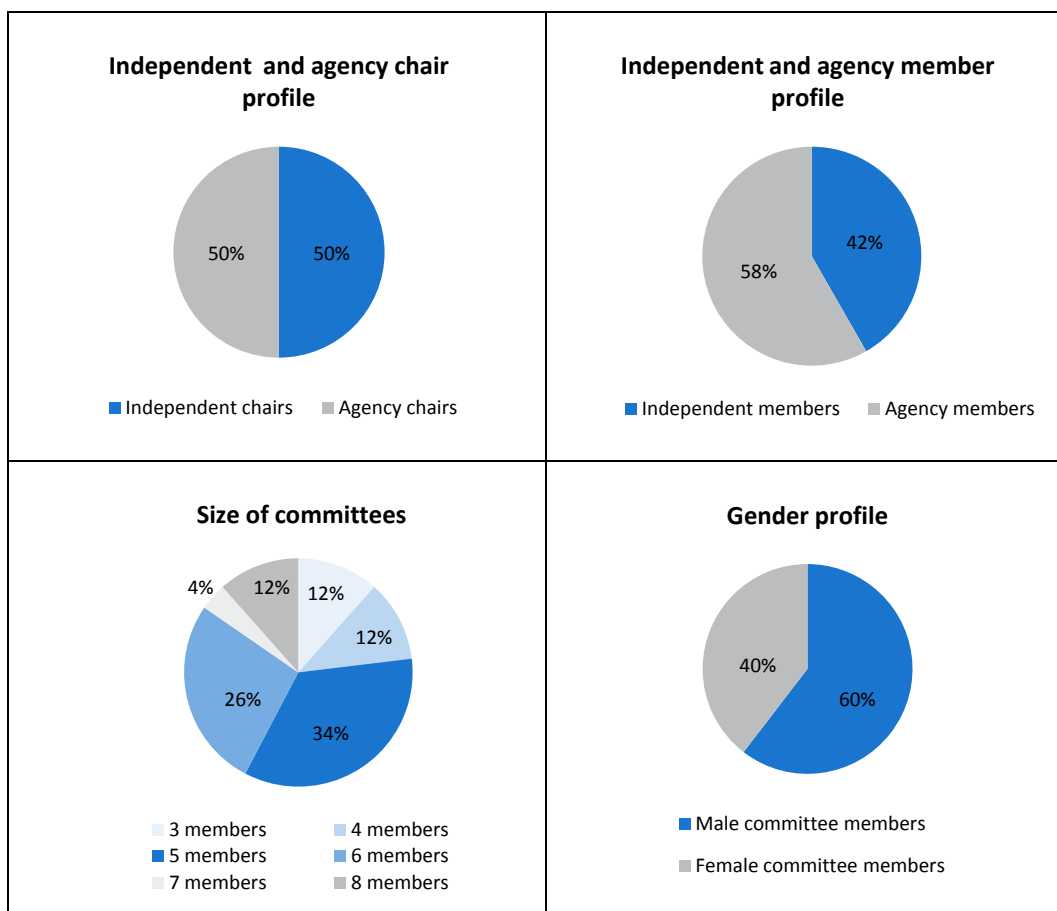
**2.26** The responsibilities of audit committees are generally consistent across all major agencies, although a number of agencies have also established separate committees or sub-committees of the Audit Committee with other governance responsibilities. For example, seven (27 per cent) agencies have separate committees with specific responsibility in relation to risk management.

**2.27** In view of the importance of the role of audit committees in reviewing the agency's annual financial statements, 14 (54 per cent) committees have now established a sub-committee with specific responsibilities for undertaking, on behalf of the committee, a more detailed review of the agency's financial statements and any issues arising from them. The ANAO encourages those

agencies that have not done so, particularly larger agencies, to consider the benefits of establishing a separate financial statement sub-committee.

**Composition of committees**

2.28 The charts below provide details of: independent and agency members; independent committee chairs; the size of committees; and the gender profile of committee members.



2.29 Of particular note is that all committees have one or more independent members, with 50 per cent of committees having an independent member as the chair. As discussed in the ANAO’s Better Practice Guide *Public Sector Audit Committees*, the appointment of external members is the most visible and

practical way to give substance to the principle of the Committee being as independent as possible from the management of the entity.<sup>14</sup>

### *Experience of committee members*

**2.30** Our enquiries identified that audit committee members generally have a broad range of skills and experience relevant to committee responsibilities. Many members have extensive public sector experience in areas such as program management, financial management, risk management, and legislative compliance. Many committee members hold senior management positions within their respective agencies and, as such, bring to bear experience and knowledge in respect of their areas of responsibilities as well as broad corporate experience.

**2.31** Importantly, the ANAO also identified that agencies involved in specialist activities such as investments and debt management have committee members with relevant specialist expertise.

### **Committee meeting arrangements**

**2.32** Audit committees generally meet between four and seven times per year with the duration of meetings usually being between two and four hours. The majority of committees also convene a special meeting to consider the agency's financial statements and the Certificate of Compliance.

## **Risk assessment process**

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

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

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<sup>14</sup> ANAO Better Practice Guide, *Public Sector Audit Committees*. February 2005, page 17.

**2.35** 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**

**2.36** Business continuity management (BCM) is an essential business practice and an integral component of effective public sector governance. It is a process encompassing both business and management disciplines to provide resilience to business processes.<sup>15</sup>

**2.37** BCM involves the development, implementation, and maintenance of those policies, frameworks and procedures to assist an agency manage a business disruption. This capability, in conjunction with agency risk management activities, assists in preventing, managing and recovering from the impacts of a disruptive event.

**2.38** 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 an 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.

**2.39** 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

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<sup>15</sup> 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.



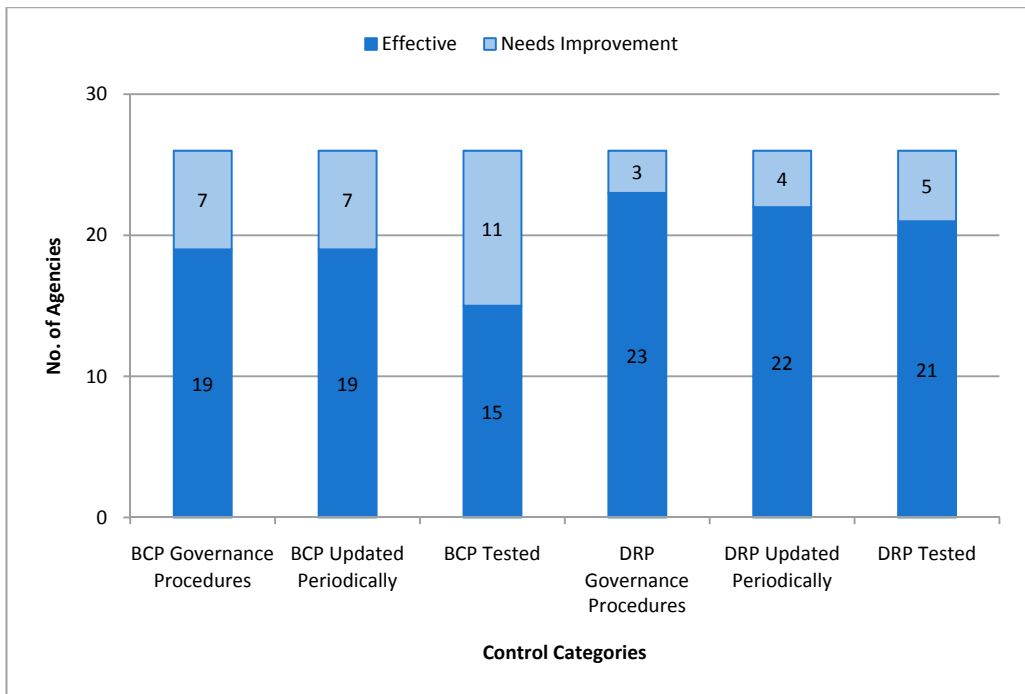
- IT Disaster Recovery Plan (DRP): the mechanism for recovering computer systems and associated infrastructure following a disruption to services, in line with the needs of the entity.

**Observations**

**2.40** Business continuity continues to be an essential element of an agency’s ability to maintain key business functions and deliver services. As part of our 2009–10 interim audits, the ANAO assessed key BCM control activities. 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 controls**



**2.41** Our audits identified that over 25 per cent of agencies do not have effective BCP governance procedures in place. Also, over 25 per cent of agencies did not maintain the currency of their BCPs. This puts at risk their capacity to deal effectively with a disruptive event.

**2.42** In addition, over 40 per cent of agencies did not test BCPs as part of normal business practice. Testing provides management with assurance that the plans will be both effective and workable. Testing also provides an

important aid to training staff. Agencies that are not regularly testing their BCP are not well placed to identify aspects of their plans that require attention, or to integrate lessons learned into revised and updated plans.

**2.43** Our audits identified that almost all agencies are addressing the need to establish effective governance procedures around DRPs. However, nearly 20 per cent of agencies had not implemented arrangements for the regular testing of DRPs. Regular testing assists agencies to establish and maintain appropriate training, effective recovery processes, and up to date DRPs.

**2.44** 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, many agencies had 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.

## **Fraud control management**

**2.45** *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 fraud<sup>16</sup> against their programs.

**2.46** 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

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<sup>16</sup> 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.

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 Australian Government, and fraud control arrangements within Australian Government agencies. This report is known as the *Annual Report to Government: Fraud against the Commonwealth*.

**2.47** 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 2009 showed that:

- the Australian Federal Police investigated 368 complex cases in 2008–09 and estimated the cost of fraud for these cases to be \$70 million;
- 5 507 defendants were referred to the Commonwealth Director of Public Prosecutions for prosecution;
- 4 089 convictions for fraud were achieved during 2008–09; and
- there were 36 acquittals for fraud during 2008–09.

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

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

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

**2.50** 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.

**2.51** In August 2004, the ANAO issued a Better Practice Guide, *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.

**2.52** 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**

**2.53** Our enquiries as part of our 2009–10 interim audits 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 continues to be an aspect that requires further attention in a number of agencies.

**2.54** In May 2010, the ANAO issued ANAO Audit Report No 42 200–10 *Fraud Control in Australian Government Agencies*. This audit assessed key aspects of Australian Government agencies' fraud control arrangements to effectively prevent, detect and respond to fraud.

**2.55** Overall, in responding to an ANAO survey, agencies advised that they had: established governance structures and allocated staff with responsibilities for fraud control; a specific policy on fraud control; undertaken a fraud risk assessment in the past two years to underpin fraud control planning, developed a fraud control plan, based on their fraud risk assessment; and provided fraud awareness raising and training for staff. In addition, targeted assurance conducted by the ANAO in a small number of agencies indicated that these agencies had made significant progress in implementing and monitoring the key fraud risk treatment strategies outlined in their fraud control plans.

**2.56** Notwithstanding this indication of improvements, our audit found that a key area of fraud management requiring greater attention by agencies is the evaluation of specific fraud control strategies.

**2.57** A recommendation addressed to all agencies was that they reassess their fraud risks and, where appropriate, the effectiveness of existing fraud control strategies, when undergoing a significant change of role, structure or function, or when implementing a substantially new program or service delivery arrangement.

## 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 the majority of agencies had effective IT general controls and FMIS and HRMIS application controls that support the preparation of agencies' financial statements. However, controls in the following areas warrant increased management attention in some agencies:

- IT incident and problem management;
- IT change management, in particular the logging and reporting of change management processes;
- the management of privileged user access to their FMISs and HRMISs; and
- the establishment, and regular testing, of a comprehensive business continuity plan.

**2.60** Given the significance of information systems and the ongoing issues identified from our assessment of IT controls, a detailed commentary is provided in Chapter 3.

## Control activities

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

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

**2.62** The auditor is required to obtain an understanding of control activities relevant to the audit, being those that the auditor considers it is necessary to understand in order to assess the risks of material misstatement, and design further audit procedures responsive to these risks.

**2.63** To 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:

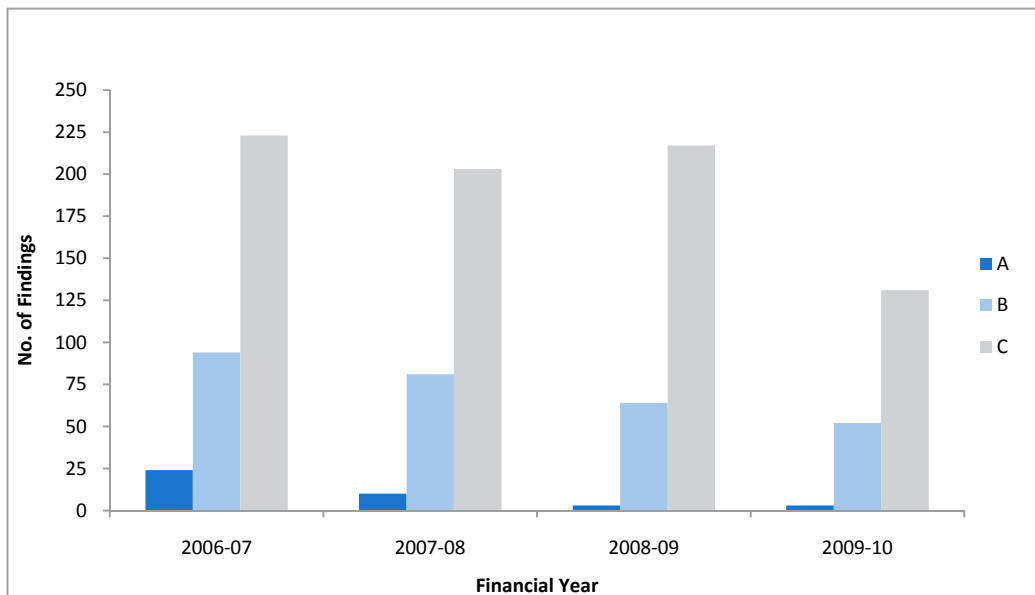
- IT control environment;
- purchases and payables;
- grant accounting;
- accounting and control of non-financial assets;
- revenues, receivables and cash management;
- human resource management processes; and
- other control matters.

### Aggregate audit findings

**2.64** 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



**2.65** Over the last four years the ANAO’s interim audits have identified some 1100 audit findings. There has been a progressive reduction in the total number of findings over this period with the majority (70 per cent) of findings

being Category C findings. There has also been a reduction in the number of A and B findings, from 68 (consisting of three Category A and 65 Category B findings) in 2008–09 to 55 (consisting of three Category A and 52 Category B findings) in 2009–10. This reflects favourably on the general standard of financial management in agencies.

**2.66** Details of audit findings by category are outlined below.

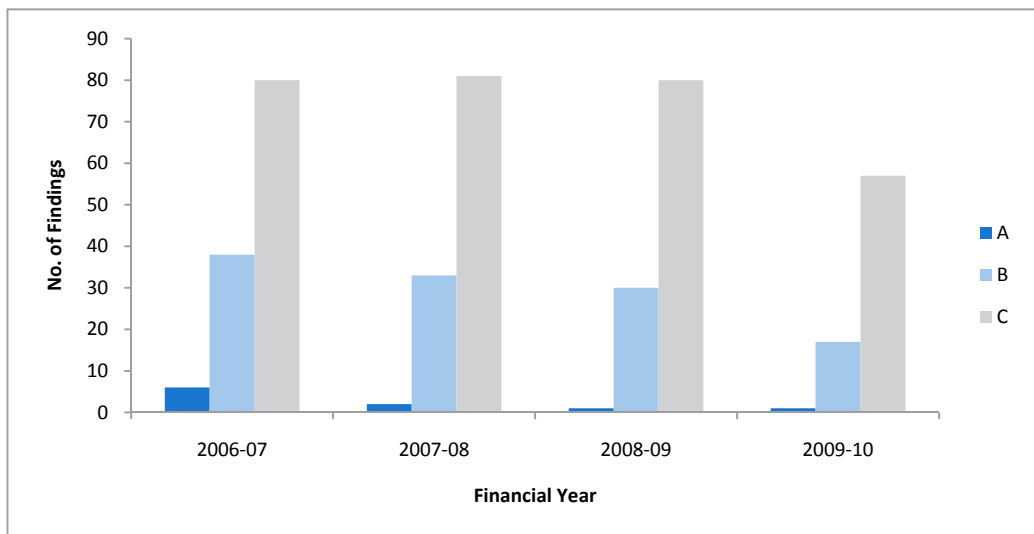
## IT control environment

**2.67** 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.

**2.68** 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



**2.69** Findings in relation to agencies' IT controls environments represent some 38 per cent of all findings, with some 426 findings in total over four years. 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, most notably in 2009–10.

**2.70** Our audits have noted an overall improvement in agencies' IT security management controls. Most agencies also have established effective IT change management controls. Areas where our audits have identified the need for improvement and controls to manage IT incident and problem management include: the regular review and updating of change management processes; and user access controls in agencies' FMISs and HRMISs, particularly the logging and review of privileged user activities and controls over generic access accounts.

### **Purchases and payables**

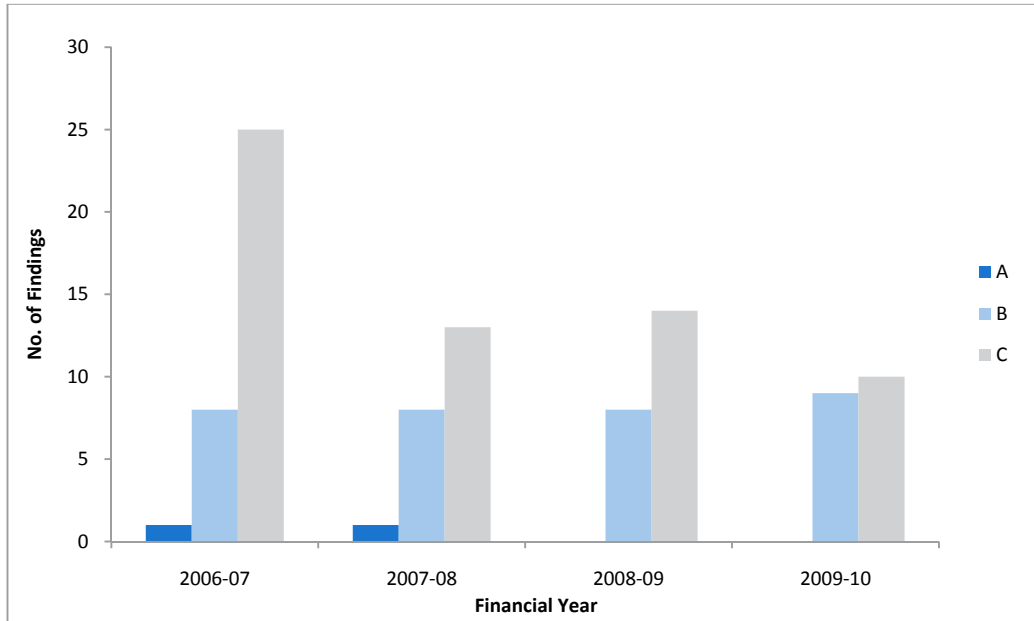
**2.71** The main component of purchases and payables is payments to suppliers, including contractor and consultancy expenses, lease payments and general administrative and utility payments. Payments to suppliers generally represent a significant percentage of total departmental expenses incurred by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

**2.72** In 2008–09, the Consolidated Financial Statements (CFS) reported total expenses for the payments of goods and services of \$63.1 billion.

**2.73** 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.

**2.74** 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**

**2.75** 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 some 9 per cent of total audit findings. The number of moderate risk (Category B) findings has slightly increased while the number of low risk (Category C) findings has reduced. 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; weaknesses in controls designed to ensure the appropriate approval of the payment of public moneys; and lack of controls over credit card expenditure. Particular issues identified in our 2009–10 interim audits relate to inadequate controls over payment files and the processing of payments.

### Grant accounting

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

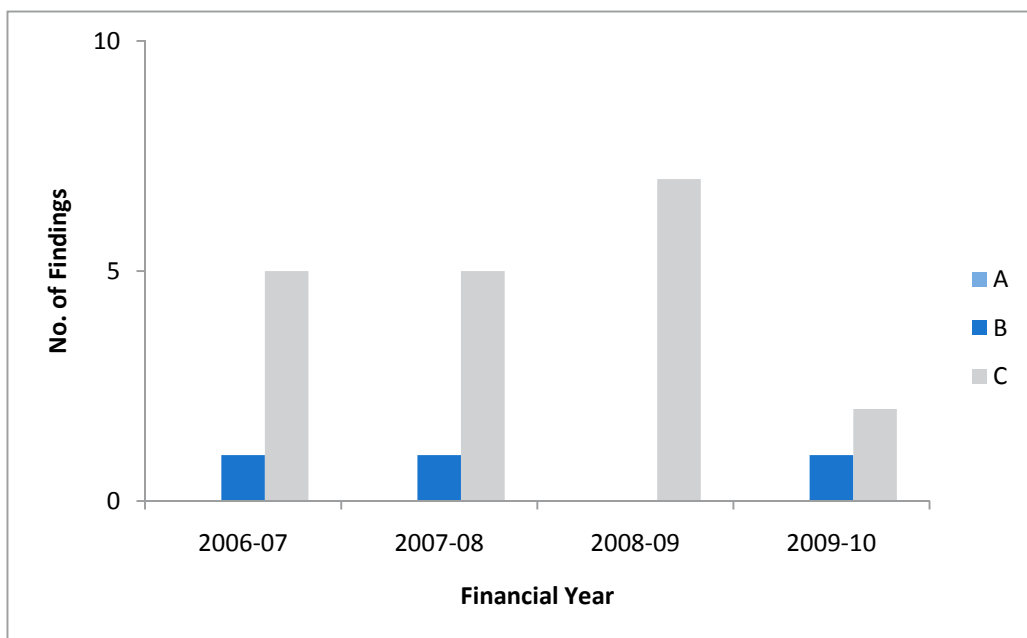
2.77 The main controls over the accounting of grant expenditure include: approval of the commitment and expenditure of grants to eligible recipients; the payment of grants in accordance with funding agreements; and controls over grant acquittals. Our interim audit work reviewed these control areas.

2.78 In 2008–09, the Consolidated Financial Statements reported total grant expenditure of \$104.2 billion.

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

**Figure 2.5**

**Grant accounting - aggregate audit findings**



2.80 Our audits have found that agencies’ controls over the payment of grants subject to audit review have been generally effective, with a very small number of audit findings, representing some two per cent of total audit findings. Common issues identified include: inadequate monitoring of payments made under grant programs; lack of reconciliations of the general ledger with grants systems; inadequate documentation to support grant payments, including the failure to acquit grants on a timely basis.

2.81 Audits of the general administration and the effectiveness of grant programs by agencies are included in the ANAO’s performance audit program. These audits generally include: 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. Our performance audits continue to identify the need for an improvement in a number of aspects of the administration of grants by agencies, including the assessment and approval of grant applications and the management of funding agreements.

**2.82** The administration of grants is governed by a range of legislative requirements. From 1 July 2009, all FMA agencies are required to adhere to the *Commonwealth Grant Guidelines* that were issued by the Minister for Finance following amendments to the FMA Regulations. The revised Guidelines list mandatory actions for Ministers and FMA Act officials, and set out seven principles<sup>17</sup> for sound grant administration that agencies should have regard to.

**2.83** An updated ANAO Better Practice Guide, *Implementing Better Practice Grants Administration*, was issued in June 2010 to assist agencies in their administration of grants.

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

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

**2.85** In 2008–09, the Consolidated Financial Statements reported total non-financial assets of some \$100.3 billion.

**2.86** 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

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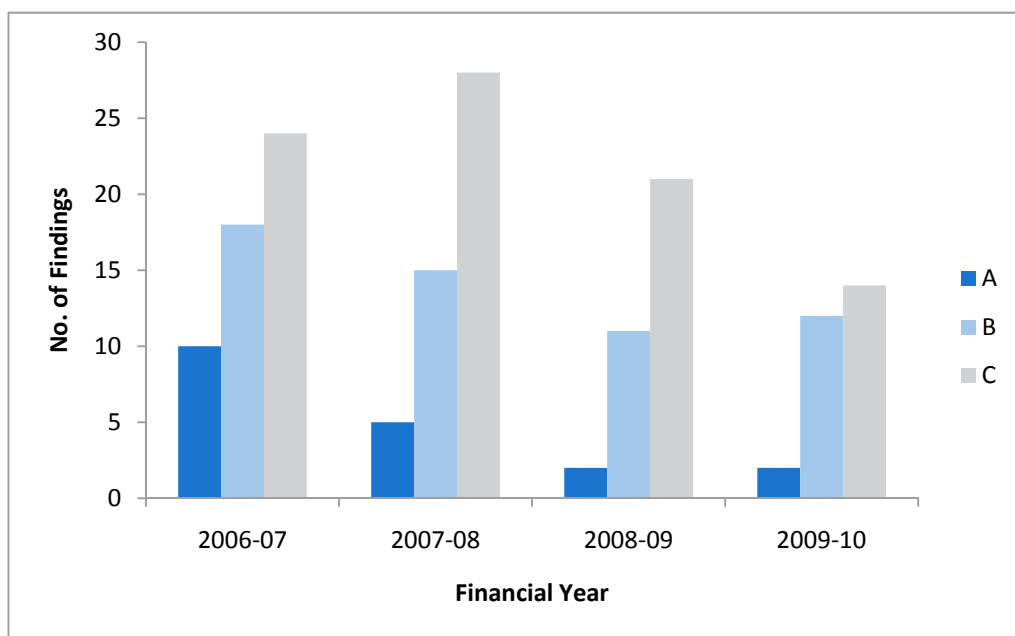
<sup>17</sup> The seven principles are: robust planning and design; an outcomes orientation; proportionality; collaboration and partnership; governance and accountability; probity and transparency; and achieving value for money.

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.

2.87 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**



2.88 Over the last four years there have been some 162 audit findings relating to the accounting and control of non-financial assets, representing approximately 15 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 the Defence Materiel Organisation 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. A particular issue identified in our 2009–10 interim audits was the accuracy of information in agencies' asset registers.

## **Revenue, receivables and cash management**

**2.89** 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.

**2.90** In 2008–09, the Consolidated Financial Statements reported total taxation revenues of \$278.3 billion, and non-taxation revenues of \$31.5 billion and reported cash totalling \$3.9 billion.

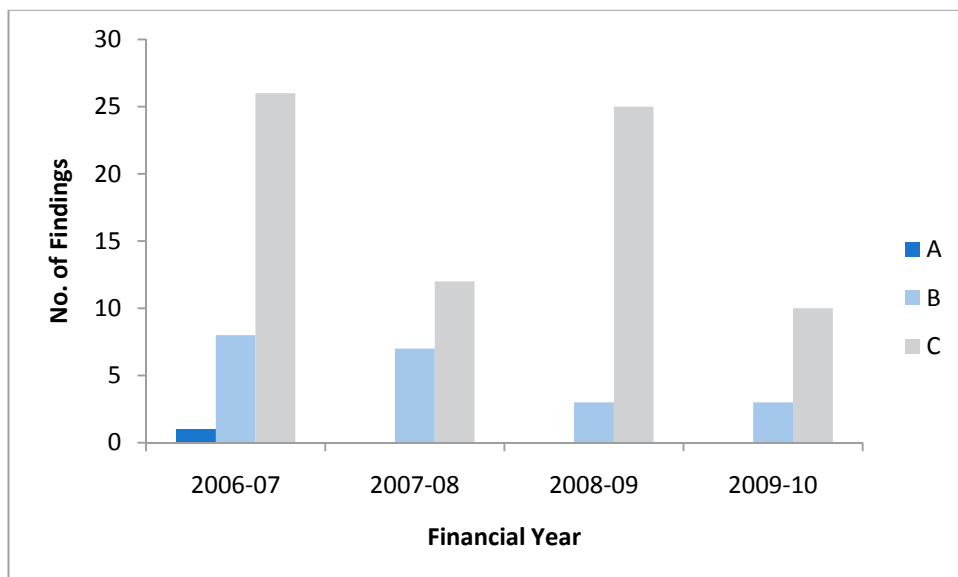
**2.91** The main controls over revenue and receivables, and on which our interim audits are focussed, include: policies for the recognition of bad and doubtful debts; the regular review of receivables; and the segregation of receipting and recording of cash functions.

**2.92** The main controls over the management of cash and on which our interim audits are 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.

**2.93** 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**



**2.94** 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 95 audit findings, representing some eight 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 2009–10, our interim audits identified a small number of findings in relation to inadequate controls over receivables and the completeness of revenue collections.

**Human resource management processes**

**2.95** 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.

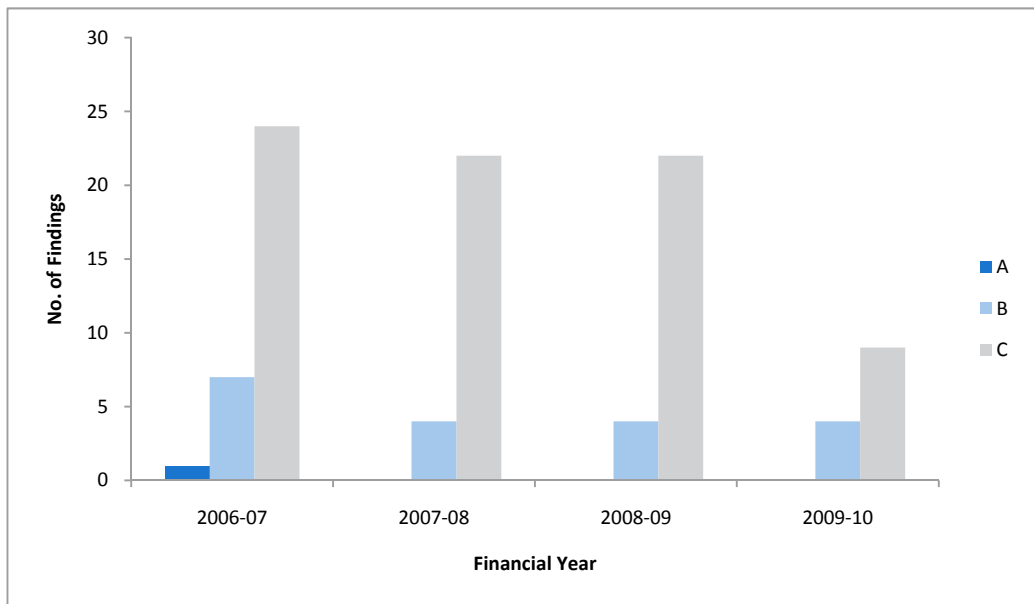
**2.96** In 2008–09, the Consolidated Financial Statements reported \$34.8 billion in employee benefits expenses.

**2.97** 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 employee 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.

**2.98** 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**



**2.99** There have been some 97 findings in this category, representing some nine 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 of 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. Our 2009–10 interim audits identified a small number of findings in relation to inadequate investigation of variances identified in reconciliations between an agency’s HRMIS and FMIS.

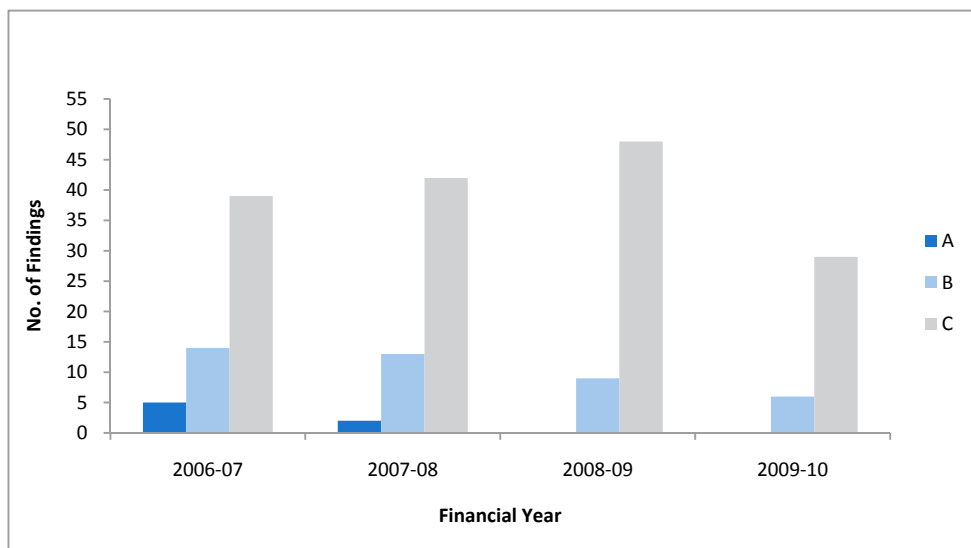
### Other control matters

**2.100** 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.

**2.101** 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



**2.102** There have been some 206 findings in this category, representing approximately 19 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 2009–10 review of BCM are outlined at paragraphs 2.36 to 2.44 above); delays in finalising service level agreements and MOUs and gaps in accountability



arrangements in agreements and MOUs in place; and the absence of, or delays in, conducting reconciliations in respect of a number of accounts or key processes. In particular, our 2009–10 interim audits identified issues relating to the accounting for commitments, and quality assurance or review processes.

## Monitoring of controls

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

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

**2.104** 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

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

**2.106** As part of its financial statement coverage, the ANAO reviews the activities of internal audit in accordance with Australian Auditing Standard ASA 610 *Using the Work of Internal Auditors*. The ANAO approach takes into account the work completed by internal audit, and, where appropriate, reliance is placed on it to ensure an effective audit approach. Before reliance is placed on specific internal audit work, ASA 610 requires a number of audit

procedures to be undertaken, 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.

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

### *Observations*

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

**2.109** 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.

**2.110** 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

**2.111** For 2009–10, agencies are required to submit audit cleared financial statement information including narrative note information to Finance by 15 August 2010. This is consistent with the 2008–09 financial statements deadline.

**2.112** Agencies' financial statement preparation processes will be reviewed as part of our 2009–10 final audits.

## Conclusion

**2.113** The results of our 2009–10 interim audits identified that, generally, the effectiveness of controls over finance and accounting processes in the majority of agencies supports the production of reliable financial statement information, reflecting the general maturity of agencies' control environments. 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

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*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 agencies.*

### Introduction

**3.1** Information Technology (IT) facilitates the way in which Australian Government agencies operate and support the business processes that deliver services to the Australian community. A review commissioned by the Australian Government estimated that the total government IT expenditure across the General Government Sector in 2007–08 was \$5.3 billion.<sup>18</sup>

**3.2** IT systems support the business processes that underpin financial statement preparation and reporting. As these processes form a key component of agencies' control environments, the ongoing evaluation of the IT control environment is a core component of the overall audit process. The ANAO reviews both IT general controls<sup>19</sup> and application controls<sup>20</sup> within these environments as part of its annual financial statement audits.

**3.3** This year's report continues our practice of including a review of key IT control categories across agencies. It provides 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.

**3.4** The chapter also includes a discussion on trends observed in the three year period 2007–08 to 2009–10 in relation to a number of IT control categories.

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<sup>18</sup> 'Review of the Australian Government's Use of Information and Communication Technology', Sir Peter Gershon, August 2008, p. 46. For the 2008–09 financial year, AGIMO has estimated IT expenditure at \$4.4 billion for FMA entities only (i.e. excludes expenditure by CAC entities).

<sup>19</sup> IT general controls are agency-wide structures, policies, procedures, and standards applied to information systems that support accounting and business processes. Effective operation of these controls helps ensure IT application controls work as intended throughout the financial year.

<sup>20</sup> IT application controls operate at the accounting and business process level, consisting of access, configuration, and reporting controls. Reliance on the effective operation of these controls provides a means to confirm the accuracy and integrity of agencies financial statements, particularly high transaction volume accounts.

## IT control environment

3.5 The ANAO assesses the design, implementation, and operation of key IT controls to determine their effectiveness in reducing risks to the integrity of financial information presented in agencies' financial statements. The ANAO undertakes this assessment in accordance with the Australian Auditing Standards each year<sup>21</sup>.

### Changes to the IT control environment

3.6 As part of our overall audit approach, a key step each year is an assessment of significant changes to agencies' IT control environments. By its nature, the IT control environment is subject to change and modification on a regular basis. For some agencies, changes to their IT systems, applications and processes represent major business change initiatives. Where relevant to the financial statements, major changes are addressed by the audit.

3.7 As part of our 2009–10 interim audits, the ANAO also assessed, where applicable, agency responses to Government-wide initiatives including the *Review of the Australian Government's Use of Information and Communications Technology* (the Gershon Review)<sup>22</sup> and the *Data Centre Strategy 2010–2025*.<sup>23</sup> The purpose of this assessment was to understand the impact, if any, of these initiatives on agencies' IT control environments and, where necessary, tailor our audit procedures accordingly.

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<sup>21</sup> Australian Auditing Standards, *ASA 315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*, AUSAB April 2006, <[www.auasb.gov.au](http://www.auasb.gov.au)>

<sup>22</sup> '*Review of the Australian Government's Use of Information and Communication Technology*', Sir Peter Gershon, August 2008. 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.

<sup>23</sup> '*Australian Government Data Centre Strategy 2010 – 2025*', AGIMO. This strategy proposes a whole-of-government approach to future data centre requirements.

## Elements of the IT Control Environment

3.8 Table 3.1 below outlines the elements of the IT control environment<sup>24</sup> reviewed by the ANAO as part of the 2009–10 financial statement audits of agencies covered by this report. A more detailed discussion of each element follows.

**Table 3.1**

### Elements of the IT control environment

<b>Control Area</b>	<b>Control Element</b>	<b>Control Categories</b>
<b>IT general controls</b>	IT security management	Security Governance Network Security Security Awareness and Training Security Monitoring and Reporting User Access Management Physical Security
	IT incident and problem management	Incident Management Processes Problem Management Processes Service Desk Configuration Management Tools Link to Change Management Analysis and Reporting
	IT change management	Policy and Governance Structures Change Logs and Reporting Release Management Approval and Tracking Emergency Changes Backout Procedures
<b>IT application controls</b>	Financial Management Information System	Payment Processing Reconciliations User Access Management Privileged User Management Business Continuity

<sup>24</sup> 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.

<b>Control Area</b>	<b>Control Element</b>	<b>Control Categories</b>
		Masterfile Maintenance Application Administration and Maintenance User Support and Training
	Human Resource Management Information System	User Support and Training Privileged User Management User Access Management Masterfile Maintenance Payroll Processing Application Change Management Business Continuity

## IT general controls

**3.9** IT general controls are the foundation of agencies' IT control structures. They are designed to increase the reliability and integrity of information and outputs generated by technology systems. Agencies' general controls continue to change in response to new business requirements. 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.

**3.10** The charts and associated commentary that follow reflect our audit assessment, grouped by the major control elements, as set out in Table 3.1 above, of 26 agencies. Where comparative figures have been included, those for 2008–09 are for 25 agencies, and the figures for 2007–08 are for 23 agencies.<sup>25</sup>

## IT security management

**3.11** 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 event, and hence risk the accuracy and completeness of agencies' financial information. Some events can also pose a risk to the legal, privacy, and

<sup>25</sup> Agencies are included in this report on the basis of being material to the Whole of Government financial statements. The total number of agencies in this category varies from year to year.



operational responsibilities of agencies, and may result in loss of public confidence.

**3.12** 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)*<sup>26</sup> and the *Australian Government Information and Communications Technology Security Manual (ISM)*<sup>27</sup>.

**3.13** 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.

**3.14** 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 frameworks, policies and procedures;
- network security processes and procedures;
- security awareness and training;
- security monitoring and reporting;
- user access management, identification and segregation of duties; and
- physical security processes and procedures.

### *Observations*

**3.15** 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.

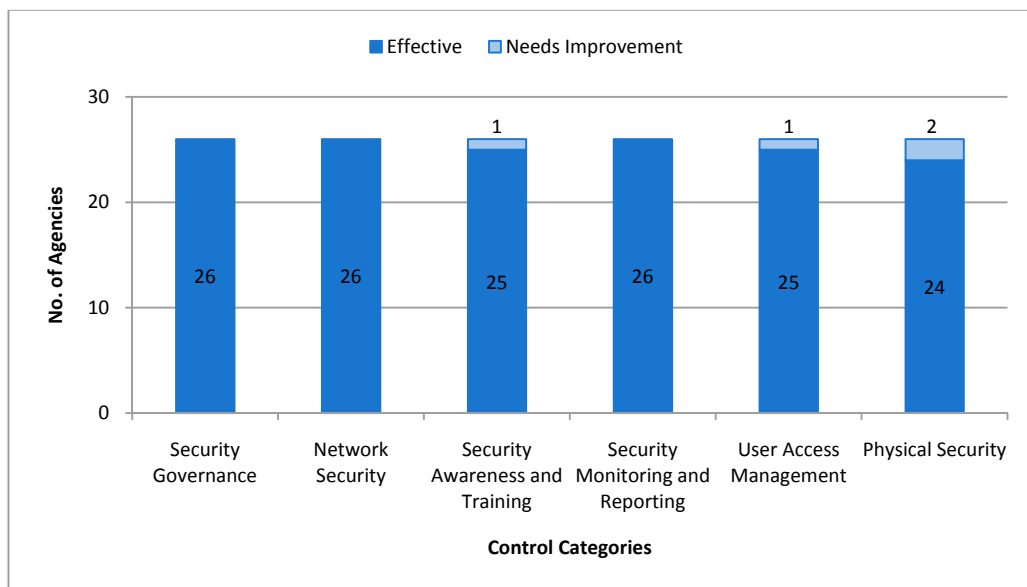
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<sup>26</sup> The *Australian Government Protective Security Manual (PSM)* sets out the policies, practices, and procedures that provide for an appropriate protective security environment.

<sup>27</sup> 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.

**Figure 3.1**

**2009–10 assessment of IT security management**



**3.16** Overall, the ANAO found the security management controls implemented by agencies were effective. In particular, all the agencies reviewed have established effective security governance frameworks and almost all agencies had implemented effective controls for managing their IT security responsibilities. The areas requiring improvement are minor, and, in most cases, being progressively addressed by agencies.

**3.17** The ANAO also observed effective controls in most agencies in the areas of security incident monitoring and reporting, and security awareness and training<sup>28</sup>.

**3.18** No systematic security governance or management failures were observed, although our audits did identify specific operational security weaknesses in some agencies, such as user access management of FMIS and HRMIS applications, which are discussed later in this chapter.

<sup>28</sup> Further discussion about this topic is in ANAO Audit Report No. 25, 2009–10 'Security Awareness and Training'. That report covers a different range of agencies, and has a scope beyond just Information Technology controls.

## IT incident and problem management

**3.19** In the normal course of business operations, agencies will be affected from time to time by IT system incidents. These incidents may interrupt or diminish the quality, accuracy, or availability of an IT system. If the handling of these incidents is not effective, they may affect an agency's level of service delivery. Incident management refers to the methods and procedures used for handling and resolving these incidents.

**3.20** Agencies may also encounter IT problems in their operations. IT problems are defined as 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 desk<sup>29</sup> approach to establish centralised and structured processes for collecting, managing, and responding to incidents and problems.<sup>30</sup> Effective implementation of a service desk assists agencies to minimise adverse impacts to service delivery from IT incidents and problems.

**3.22** The following control categories for incident and problem management were 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 are outlined in Figure 3.2 below.

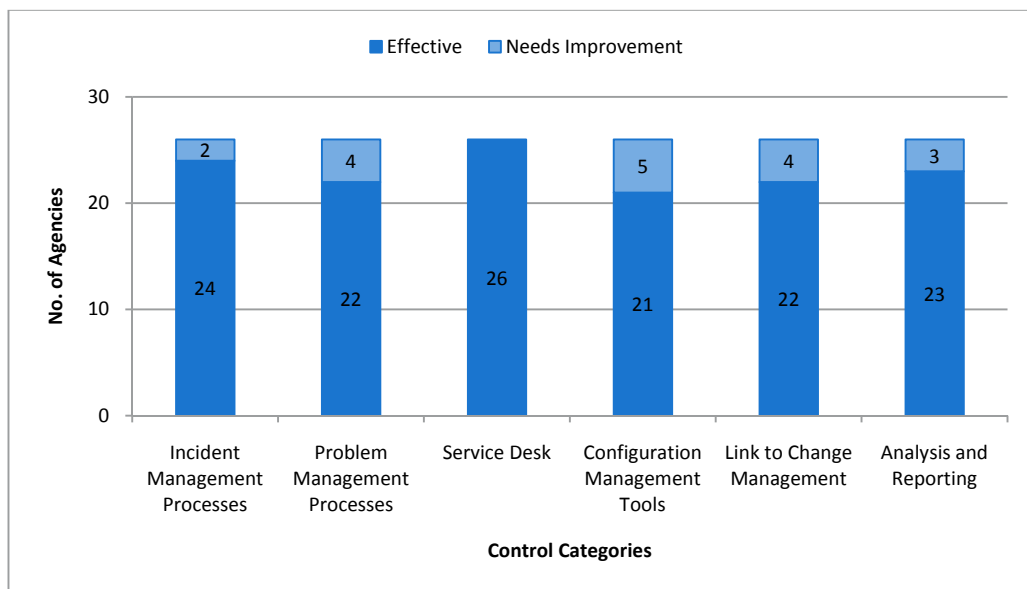
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<sup>29</sup> Also commonly referred to as an IT Helpdesk.

<sup>30</sup> 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**

**2009–10 assessment of IT incident and problem management**



**3.24** Overall, our 2009–10 audits identified that the incident and problem management controls implemented by agencies have been effective. In particular, the use of a service desk as a central management point for IT incidents and problems is now well established in all agencies reviewed. Nevertheless, there are improvements warranted in some agencies, across a number of areas.

**3.25** Almost 20 per cent of agencies had not implemented a working, integrated configuration management tool. These are tools used to store system hardware and software information in a central location, and in a common format. A lack of centralised information about the IT environment may complicate the installation of new hardware, software, or affect the capacity to recover from a business continuity or disaster recovery event.

**3.26** A number of agencies would benefit from improvements to their problem management processes. Almost 20 per cent of agencies did not have processes in place to enable a consistent and repeatable response to resolve problems.

**3.27** Another area of agency focus for agency improvement is the linking of incidents to change management processes. By monitoring a link between incidents and resulting change management processes, the risk of mistakenly

closing, or not fully resolving, escalated incidents is significantly reduced. This linkage also assists in the appropriate definition, testing, implementation, and reporting of resolution activities.

**3.28** Integrating incident and change management processes will aid in improving the IT control environment within an agency, and, over time, reduce the number and severity of incidents and/or problems.

## **IT change management**

**3.29** The IT change management process is a standardised approach for agencies making general changes to an IT environment. A change management process covers changes to all technology and communications components, including networks, hardware platforms, application software, and requires appropriate supporting process and procedure documentation. The aim of the change management process 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.

**3.30** The ANAO tested controls supporting the change management process, in the context of agencies' financial statements, in the following key categories:

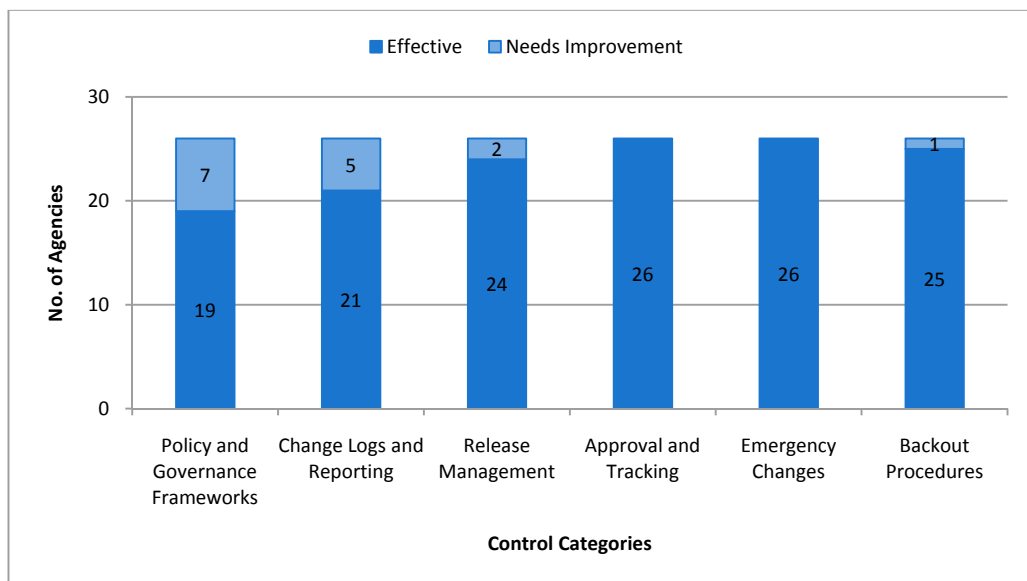
- change management policy and governance frameworks;
- change logs and reporting;
- release management procedures;
- change approval, prioritisation and tracking;
- emergency change procedures; and
- change backout procedures.

### *Observations*

**3.31** The findings from our testing of IT change management controls are summarised in Figure 3.3 below.

**Figure 3.3**

**2009–10 assessment of IT change management**



**3.32** Overall, most agencies had effective change management policies and governance frameworks. However, over 25 per cent of agencies did not regularly update their change management processes. As ICT environments are continuously changing, these processes need to remain current for a change process to be consistent and reliable.

**3.33** In addition, a number of agencies had not fully implemented audit logging and reporting over their change management process. This situation reduces the level of management oversight and control over system changes, and increases the risk of system changes being implemented that may affect the integrity of financial information.

### IT application controls

**3.34** Australian Government agencies generally rely on two key financial reporting systems in the preparation of financial information. These are the Financial Management Information System (FMIS) and the Human Resource Management Information System (HRMIS).

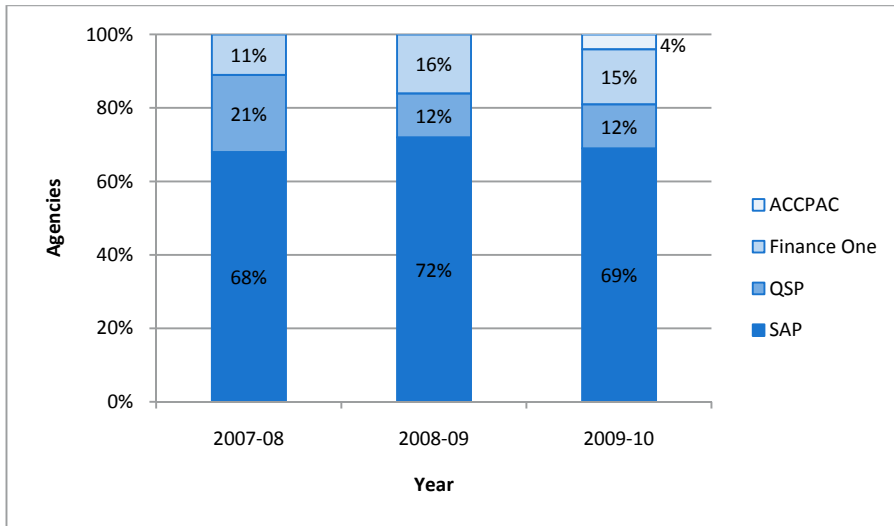
**3.35** Due to their importance for financial reporting, the ANAO reviews the key controls of FMIS and HRMIS systems across all major agencies. While there is a range of application systems utilised by agencies, similar sets of

controls are required to help preserve the reliability and integrity of financial information.

3.36 The figures below detail the various FMIS and HRMIS financial reporting applications used by the agencies covered by this report.

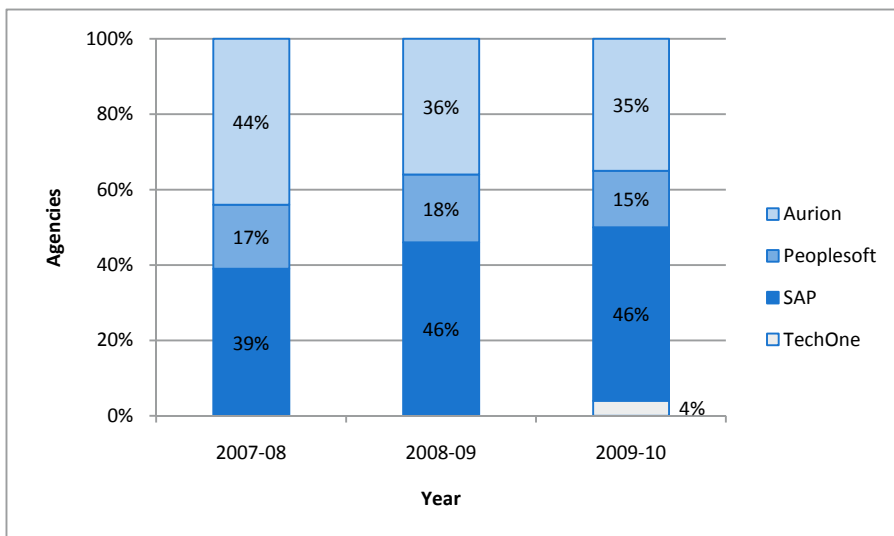
**Figure 3.4**

**Summary of FMIS applications 2007–08 to 2009–10**



**Figure 3.5**

**Summary of HRMIS applications 2007–08 to 2009–10**



**3.37** The ANAO observed that there has not been any reduction in the range of applications utilised by agencies over the past three years. In fact, there has been an increase in the number of different systems used across agencies in the past 12 months.

## **Financial Management Information Systems**

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

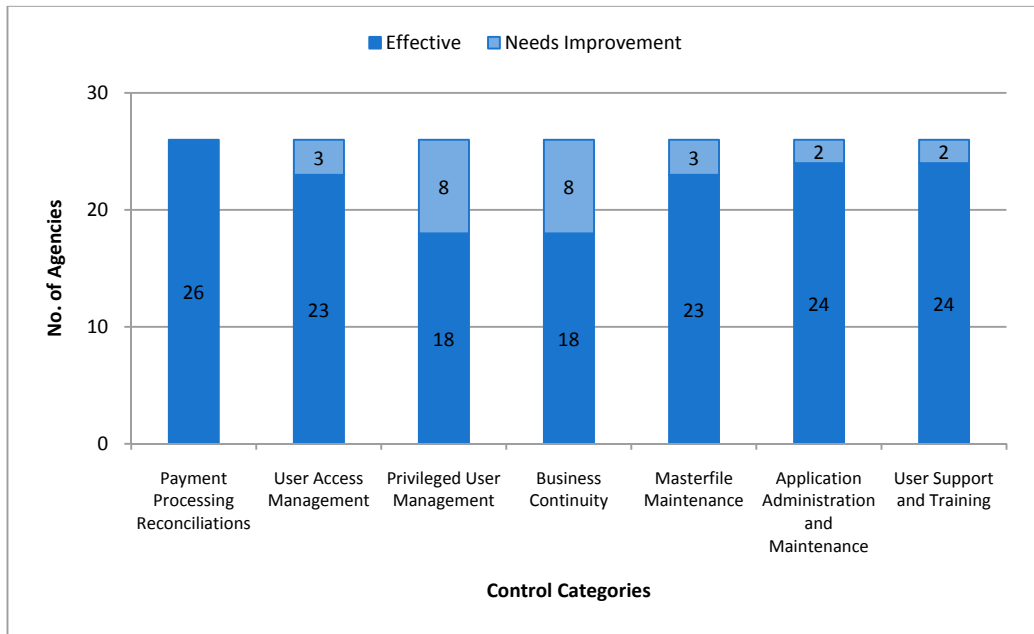
**3.39** The following FMIS control categories were reviewed as part of the 2009–10 financial statement audits:

- 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 the key FMIS control categories integral to effective financial management and reporting, in the context of agencies' financial statements, is summarised in Figure 3.6 below.



**Figure 3.6****2009–10 assessment of FMIS's**

**3.41** The key FMIS controls used to support the preparation of financial statements were generally effective in the majority of agencies. In particular, agencies surveyed had systems in place to ensure that the reconciliation of payment processing files occurred. This is a key control designed to ensure the integrity of financial information.

**3.42** However, the ANAO identified inadequate privileged user management in over 30 per cent of agencies. The primary weakness noted was the absence of logging of user activities. This is an important control for preventing or detecting inappropriate use of the access to financial information.

**3.43** In addition, over 30 per cent of agencies did not have a comprehensive and tested business continuity plan in place for their FMIS. The most common weakness was that the testing of plans was not regular or effective. Any failure in the FMIS resulting from a business disruption event could have significant consequences for an agency's capacity to maintain the completeness, accuracy, and availability of its financial information. While FMIS applications should be part of broader agency business continuity plans, their critical importance means that its specific continuity plan should be subject to regular testing and updating when required.

## Human Resource Management Information Systems

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

3.45 The key categories of HRMIS controls reviewed as part of the audit coverage were:

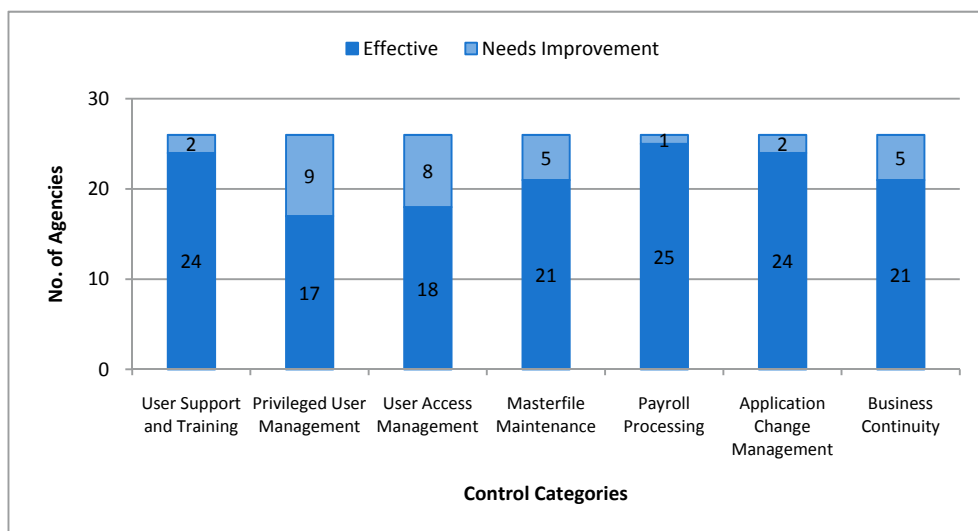
- user support and training;
- privileged user management;
- user access management;
- maintenance of masterfile reference information;
- payroll processing management;
- application change management; and
- application business continuity procedures.

### Observations

3.46 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 Figure 3.7 below.

**Figure 3.7**

### 2009–10 assessment of HRMIS's



**3.47** The key HRMIS controls used to support the preparation of financial statements were generally effective in the majority of agencies. However, there were some exceptions relating to privileged and general user management controls. Similar to the FMIS control assessment, the area of greatest control weakness relates to HRMIS privileged users. Appropriately managing HRMIS system administrators and other users who have high levels of access to HRMIS financial transactions and information is required to manage the risk of inappropriate access.

**3.48** In addition, management of HRMIS general user access, involving situations where users are making changes to human resources data, is an area requiring improvement. Over 30 per cent of agencies did not have effective controls in this area. Poor practices around general user management, such as insufficient activity logging, present a risk to the reliability and integrity of agencies' HR-related financial information.

## **Trends over the period 2007–08 to 2009–10**

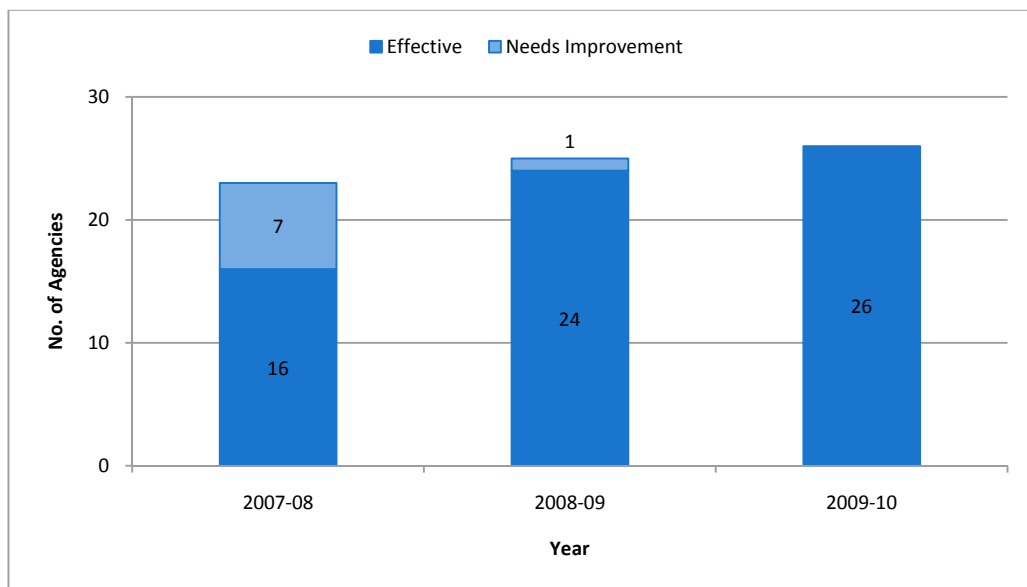
**3.49** Through ongoing assessment of agencies' IT control environments, the ANAO has identified a number of trends over the period 2007–08 to 2009–10 for particular control categories. Some trends point to areas that have improved over the last three years, while others suggest that further management attention is required in a number of agencies. The most significant of these trends are discussed below.

### **IT security governance**

**3.50** IT security governance frameworks are an overarching set of structures, policies, and procedures that address security matters within an agency. As illustrated in Figure 3.8 below, over the last three years, a positive trend was identified in respect of IT security governance within agencies.

**Figure 3.8**

**IT security governance: 2007–08 to 2009–10**

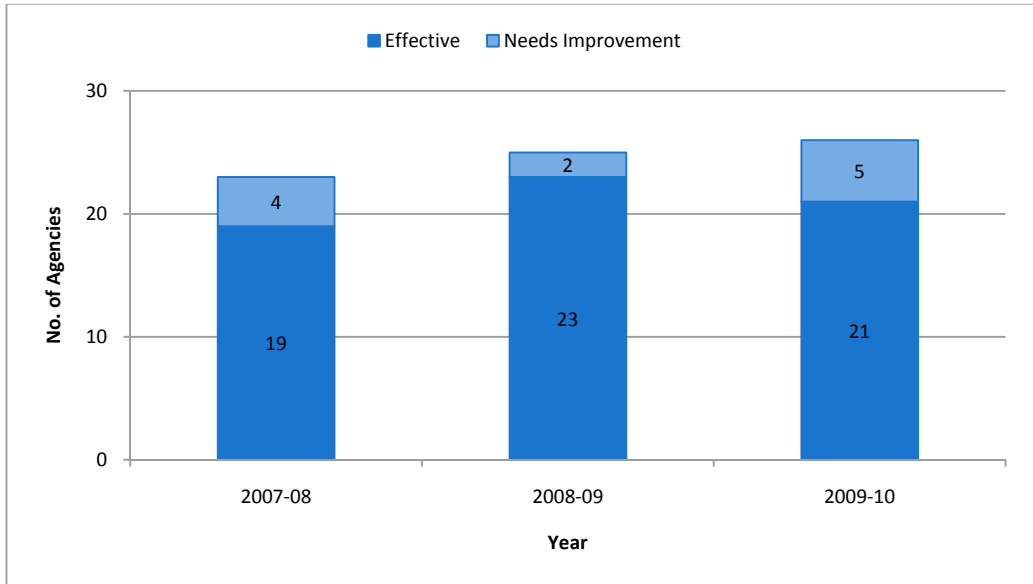


**3.51** Over the past three years, there has been a continuing improvement in the effectiveness of agency security frameworks. In 2007–08, over 30 per cent of agencies did not have effective security governance frameworks; all agencies reviewed in 2009–10 have effective controls in place.

**3.52** The improvement indicates that agencies have implemented procedures to establish, regularly maintain, and update their security governance frameworks. This positions agencies to remain current with technical innovations, and organisational changes.

**Configuration management tools**

**3.53** Configuration management tools, such as a Configuration Management Database (CMDB), assist agencies to maintain the integrity of technology systems by storing system hardware and software information in a central location and in a common format. The ANAO observations regarding configuration management tools are summarised in Figure 3.9 below.

**Figure 3.9****Configuration management tools: 2007–08 to 2009–10**

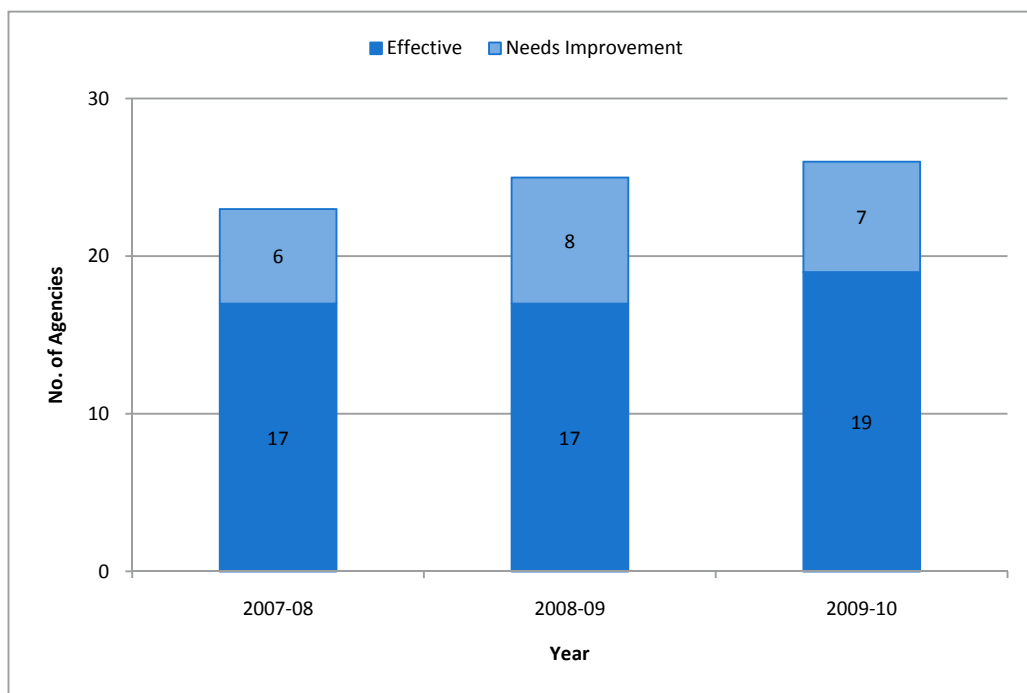
**3.54** The adoption and use of these tools improved in 2008–09 but declined in 2009–10. ANAO testing indicated that almost 20 per cent of agencies do not utilise such a tool, or had not implemented a process for updating the tool regularly. While some agencies had initiated projects to create and populate a CMDB, until these processes have been implemented, and the CMDB is regularly updated, procedures for managing incidents and problems may be less efficient and effective.

### **IT change management policy and governance frameworks**

**3.55** IT change management policy and governance frameworks assist to create a consistent and reliable approach to making changes to the IT environment of an agency. The ANAO observations regarding change management policy and governance frameworks over the past three years are summarised in Figure 3.10 below.

**Figure 3.10**

**Change management policy and governance frameworks: 2007–08 to 2009–10**

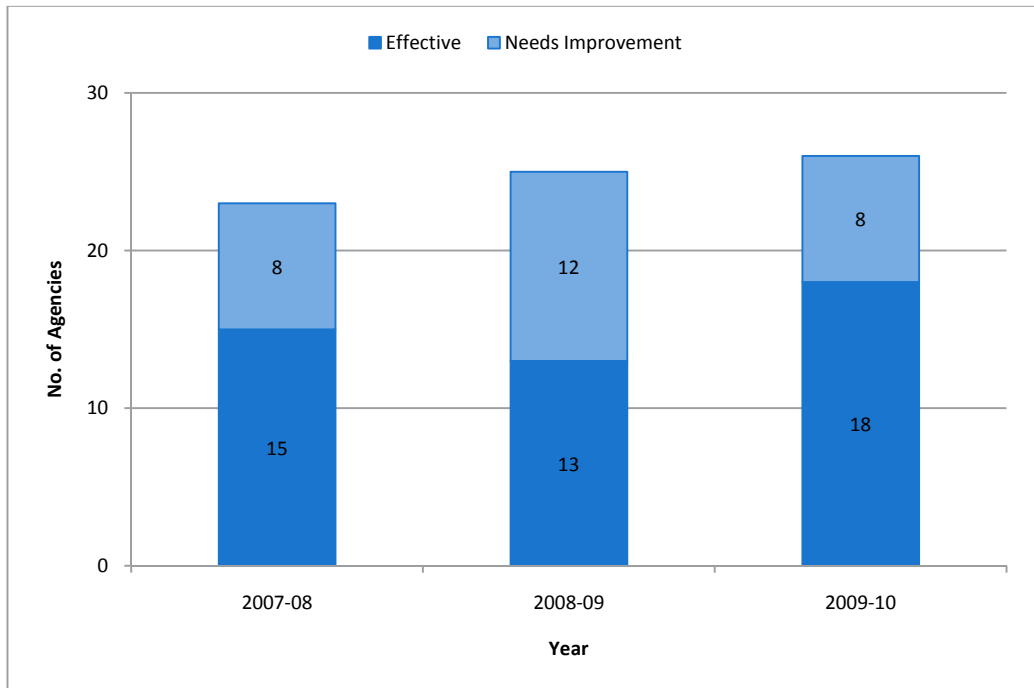


**3.56** The policy and governance structures that support change management processes have shown little improvement over the past three years. Our testing identified that over 25 per cent of agencies do not regularly review and maintain their change management policy and governance frameworks.

**3.57** Due to the continually changing nature of the IT environment, the controls surrounding change management require regular review to ensure they remain current and applicable. This reduces the risk that system changes will affect system availability.

### **FMIS privileged user management**

**3.58** FMIS privileged user management involves implementing a regime of system restrictions on users in respect of their access rights to edit and change data within the FMIS. The ANAO observations regarding FMIS privileged user management over the past three years are summarised in Figure 3.11 below.

**Figure 3.11****FMIS privileged user management: 2007–08 to 2009–10**

**3.59** While the administration of FMIS privileged user accounts has improved from the previous year, over 30 per cent of agencies are not effectively managing the risks arising from this level of access to financial information.

**3.60** A common issue identified by the ANAO relates to the lack of logging of privileged user activities. 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.

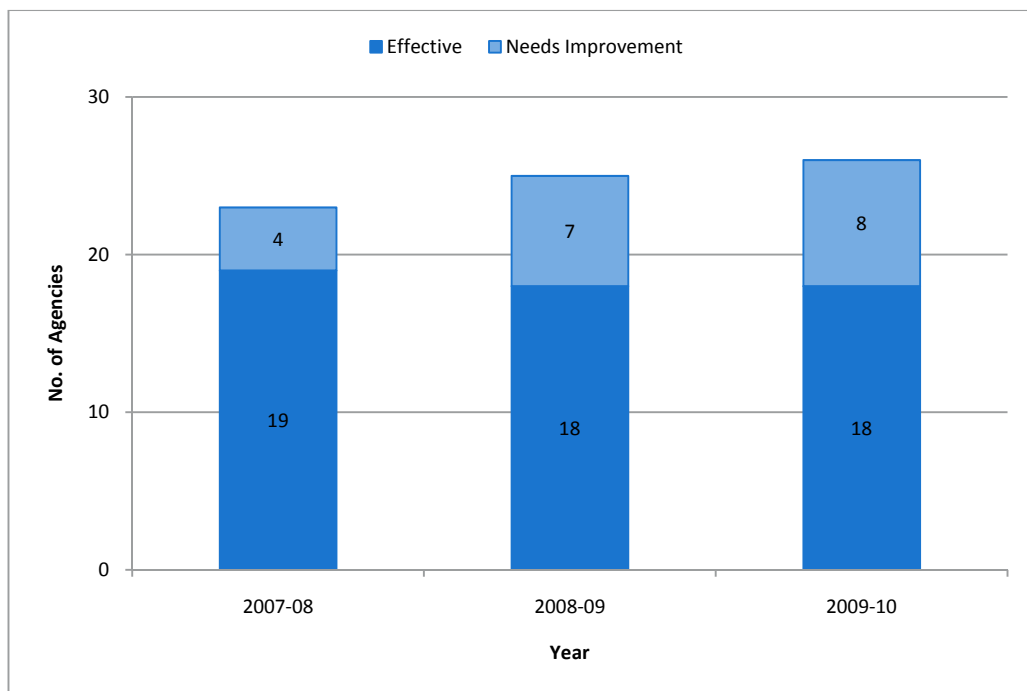
**3.61** The weaknesses identified in privileged user access management were not confined to particular FMIS applications. Improving controls is dependent on the processes, procedures, and management controls that an agency puts in place for its privileged users.

## FMIS business continuity

3.62 In view of the key role of the FMIS in the effective management of an agency, it is important to have a business continuity plan for the FMIS in place. The ANAO observations regarding the management of FMIS business continuity risks over the past three years are summarised in Figure 3.12 below.

Figure 3.12

### FMIS business continuity: 2007–08 to 2009–10



3.63 The effectiveness of FMIS business continuity arrangements has declined over the past three years. In 2007–08, almost 20 per cent of agencies were not effectively implementing controls to manage this risk. In 2009–10, this has risen to over 30 per cent of agencies.

3.64 The management of this risk requires business continuity plans to be well designed, regularly tested, and updated as required. The trend over recent years suggest that there is an increasing risk that some agencies will not be able to fully, or effectively, recover financial information if a business disruption occurs.

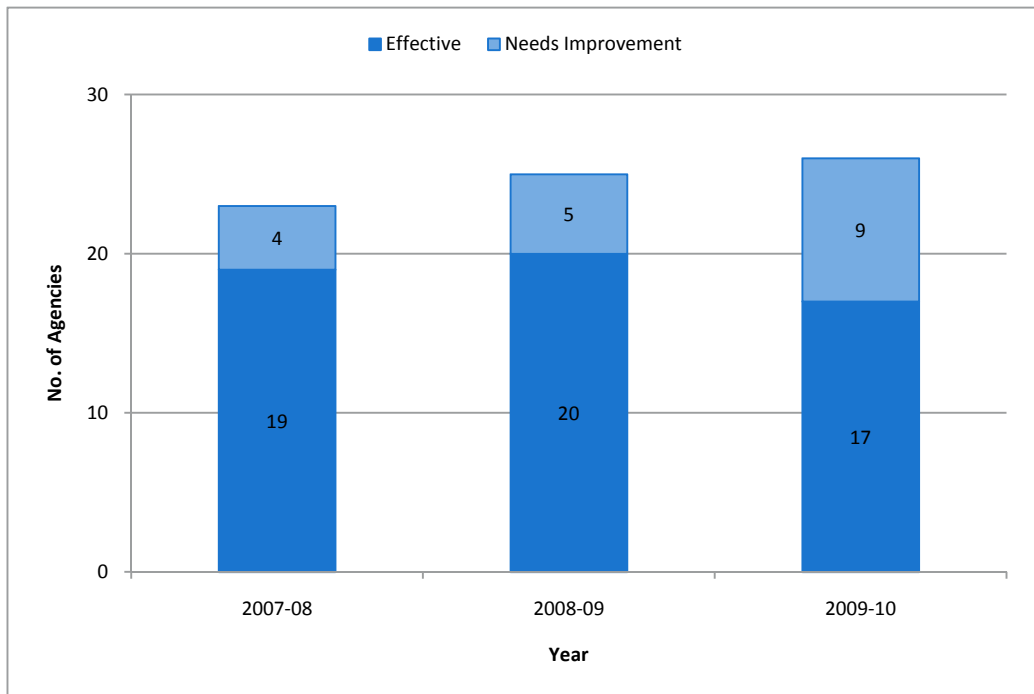


## HRMIS privileged user management

**3.65** HRMIS privileged user management involves implementing a regime of system restrictions on users in respect of their access rights to edit and change data within the HRMIS. The ANAO observations regarding HRMIS privileged user management over the past three years are summarised in Figure 3.13 below.

**Figure 3.13**

### HRMIS privileged user management: 2007–08 to 2009–10



**3.66** The administration of HRMIS privileged user accounts remains an area that many agencies are not effectively managing. In 2007–08, almost 20 per cent of agencies needed to improve their controls in this area. In 2009–10, over 30 per cent of agencies did not have administrative arrangements in place to effectively manage users with privileged access. As these users typically have full access to all HRMIS financial transactions and information, there is an increased risk to the integrity of financial and other information in the HRMIS.

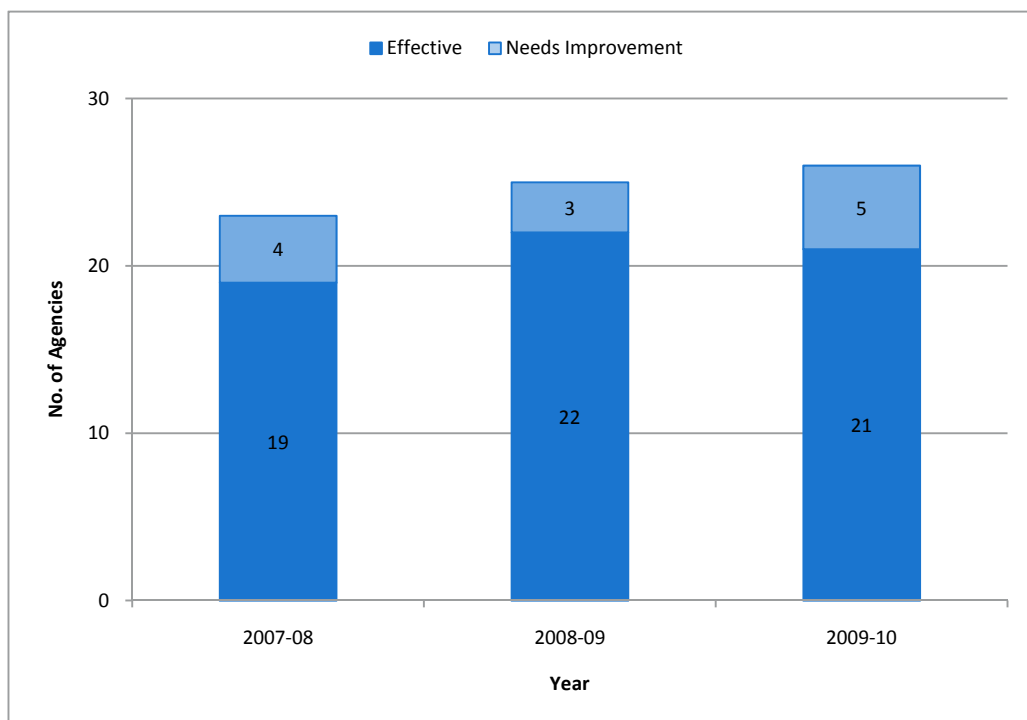
**3.67** As with FMIS, weaknesses in privileged user access management is not confined to particular HRMIS applications. Improving controls is dependent on the processes, procedures, and management controls that an agency puts in place for its privileged users.

## HRMIS business continuity

**3.68** In view of the key role of the HRMIS in the effective management of an agency, it is important that agencies have a business continuity plan for the HRMIS. The ANAO observations regarding the management of HRMIS business continuity risks over the past three years are summarised in Figure 3.14 below.

**Figure 3.14**

### HRMIS business continuity: 2007–08 to 2009–10



**3.69** The effectiveness of HRMIS business continuity arrangements have not improved over the past three years. In 2009–10, around 20 per cent of agencies did not have effective business continuity arrangements, a situation similar to 2007–08.

**3.70** Management of this risk requires business continuity plans to be well designed, regularly tested, and updated as required. As there has been no lasting improvement in this control over recent years, there is a continuing risk that some agencies will not be able to fully, or effectively, recover human resources information if a business disruption occurs.

## Conclusion

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

**3.72** The overall improvement in agencies' security management controls has been a positive development observed during the 2009–10 audits. Agencies have generally been able to demonstrate a sufficient level of security awareness and training and there have been improvements in agency security monitoring and reporting practices.

**3.73** However, the ANAO has identified areas for improvements within other key IT general controls. Our assessment of incident and problem management controls revealed that the effective use of CMDB tools has declined. Over 25 per cent of agencies could also improve their change management policy and governance frameworks by regularly reviewing and updating their change management processes. In addition, many agencies have not fully implemented audit logging and reporting of system changes.

**3.74** The management of user access, particularly the logging and monitoring of user activities for privileged users, is also an area that requires attention in some agencies. The ongoing effectiveness of user access controls is an important element in maintaining the integrity of agencies' financial information. To address these weaknesses, agencies should ensure that they have appropriate user access policies and procedures in place across the entire IT environment. Such policies and procedures should be in alignment with the agencies' information security policies.

**3.75** In future audits, the ANAO will focus attention on FMIS and HRMIS management processes, particularly user access, privileged user access, and business continuity. The ANAO will also continue to assess the impact on the IT control environment of changes arising from major change initiatives.

**3.76** The ANAO will also continue to monitor technology trends and their potential impact on the control environments of Australian Government agencies.



## 4. Interim Audit Results by Agency

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*This chapter summarises the results of the interim phase of the 2009–10 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 2010. 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 progressively to allow agencies to submit audit cleared financial information to Finance<sup>31</sup> for the purposes of informing government of the General Government Sector's financial outcome for the 2009–10 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 for the year ended 30 June 2010, expected to be tabled in December 2010.

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

- a summary of the agency's business operations and the key characteristics of these operations that shape the ANAO's 2009–10 audit coverage;
- key financial figures and staffing levels for 2008–09 and 2009–10<sup>32</sup>;
- governance arrangements relevant to the agency's financial management responsibilities;

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<sup>31</sup> The deadlines for the submission of audit cleared information are 15 August for material agencies and 31 August for non-material agencies.

<sup>32</sup> These figures are sourced from each agency's 2010–11 Portfolio Budget Statements, audited 2008–09 financial statements, or as advised by agencies.

- the key areas of audit focus for the audit of the 2009–10 financial statements; and
- the significant and moderate (Category A and B) audit findings and the conclusion relating to the audit coverage undertaken to date.

**4.5** Category C audit findings reported to management relate to 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 identified during our audits are rated in accordance with the seriousness of the particular matter. The assigned rating 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 matters remaining unresolved at the time of the subsequent year's audit, depending on the seriousness of the issue, may be given a higher rating.

**4.9** The following table provides details of the number of Category A and B findings relating to each agency identified in our 2008–09 and 2009–10 interim audits.

**Table 4.1**

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

Entity	2009–10 Rating		2008–09 Rating	
	A	B	A	B
Department of Agriculture, Fisheries and Forestry	0	0	0	1
Attorney–General’s Department	0	0	0	3
Australian Customs and Border Protection Service	0	4	0	3
Department of Broadband, Communications and the Digital Economy	0	1	0	0
Department of Climate Change and Energy Efficiency	0	0	0	0
Department of Defence	1	20	2	25
Defence Materiel Organisation	0	7	0	12
Department of Veterans’ Affairs	0	4	0	1
Department of Education, Employment and Workplace Relations	0	1	0	1
Department of the Environment, Water, Heritage and the Arts	0	1	0	0
Department of Families, Housing, Community Services and Indigenous Affairs	0	2	0	0
Department of Finance and Deregulation	0	1	0	2
The Board of Guardians and the Future Fund Management Agency	0	0	0	0
Department of Foreign Affairs and Trade	0	0	0	5
Department of Health and Ageing	0	0	0	0
Department of Human Services	0	0	0	0
Centrelink	0	0	0	1
Medicare Australia	0	0	0	0
Department of Immigration and Citizenship	0	2	0	3
Department of Infrastructure, Transport, Regional Development and Local Government	0	0	0	0
Department of Innovation, Industry, Science and Research	0	1	0	0
Department of the Prime Minister and Cabinet	0	0	0	0
Department of Resources, Energy and Tourism	1	0	0	0
Department of the Treasury	0	1	0	1
Australian Office of Financial Management	0	0	0	0
Australian Taxation Office	1	7	1	7
<b>Total</b>	<b>3</b>	<b>52</b>	<b>3</b>	<b>65</b>

Source: ANAO

# Agriculture, Fisheries and Forestry Portfolio

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## Department of Agriculture, Fisheries and Forestry

**4.10** 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. DAFF's role is to contribute to the overall portfolio aims of enhancing the sustainability, profitability and competitiveness of Australia's agricultural, fisheries and forestry industries. The department aims to achieve this by:

- maintaining existing markets and developing new trading opportunities;
- ensuring Australia plays a strong role in efforts to tackle global food security;
- helping primary industries prepare for climate change, droughts and extreme weather events;
- boosting productivity by investing in research and development, skills and training, innovation, and promoting the use of new technologies; and
- reforming its biosecurity system to help prevent pests and diseases being introduced, and to prepare for future challenges, such as climate change and the increased movement of people and goods.

**4.11** The key characteristics of DAFF's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the large number of grants and subsidies programs administered by the department;
- a self assessment regime for the collection and reporting of levies revenue administered by DAFF;
- a complex network of IT based business systems and associated processes, particularly those that support the management of grants payments, levies revenue, and Australian Quarantine and Inspection Service's (AQIS) revenue streams; and



- the large number of personal benefits payments made by Centrelink on behalf of DAFF.

## Financial overview

4.12 DAFF's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	352	354		
Appropriation revenue	352	344		
Administered income			351*	538
Administered expenses			1 048**	1 751
Total assets	228	249	257	251
Total liabilities	221	231	88	121

\*The reduction in budgeted administered income is principally due to the abolition of the Dairy Adjustment Levy in February 2009.

\*\*The reduction in budgeted administered expenses is mainly due to changes in arrangements for certain program payments that are now made by the Treasury to the States and Territories.

DAFF's estimated average staffing level for 2009–10 is 4 439 (2008–09 : 4 485)

## Governance arrangements

4.13 The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DAFF's business objectives. These arrangements also support the achievement of DAFF's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.14 The key elements of DAFF's governance arrangements include:

- an Executive Management Team (EMT) that meets monthly and provides leadership to DAFF's divisions on administrative and operational aspects and provides advice to the Secretary on strategic policy, budgets and performance;
- various governance committees that support the EMT, including an audit committee which meets a minimum of 5 times a year and focuses on financial reporting, internal control structures, risk management systems, internal and external audit functions and fraud control;

- a financial statements audit sub-committee that meets at least five times a year and oversees the preparation of the annual financial statements;
- an internal audit function that provides planned risk-based audit coverage of DAFF's operations, including its quarantine and biosecurity functions;
- a Corporate Plan that provides an overview of DAFF's directions for the future, including corporate outcomes and strategies to address challenges and pressures; and
- a fraud control plan and risk management plan which provide a high level overview of the systems in place to identify, monitor and manage risks and fraud.

## **Areas of audit focus**

**4.15** In the light of the ANAO's understanding of DAFF's environment and governance arrangements, which include a financial reporting regime and a system of internal control, the ANAO's audit approach has identified the following areas of audit focus that have the potential to significantly impact DAFF's financial statements:

- expenditure relating to grants and subsidies, including grants expenditure managed by DAFF, and paid by the Treasury;
- levies revenue and receivables, and the operation of an associated compliance program designed and implemented by DAFF to provide assurance over the completeness and accuracy of levies received;
- significant AQIS revenue systems, including import and export systems; and
- personal benefits expenses and payables, including coverage of the controls relating to personal benefits programs, mainly associated with drought relief, that are administered by Centrelink on behalf of DAFF.

**4.16** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.17** The ANAO has assessed the risk of material misstatement in DAFF's 2009–10 financial statements as moderate.

## **Audit results**

**4.18** The ANAO has performed interim testing in relation to the main areas of audit focus outlined above and no significant or moderate issues were identified. The ANAO will complete its review of levies revenue during the 2009–10 final audit.

## **Conclusion**

**4.19** Based on the interim audit work to date, the department's internal controls are operating effectively to provide reasonable assurance that DAFF can prepare financial statements that are free of material misstatement.

# Attorney-General's Portfolio

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## Attorney-General's Department

**4.20** The Attorney-General's Department (AGD) is the central policy and coordinating agency of the Attorney-General's portfolio. AGD contributes to the Australian Government's commitment to a more secure, stronger and fairer Australia, and an Australia capable of meeting new challenges through three outcomes:

- an equitable and accessible system of federal civil justice;
- coordinated federal criminal justice, security and emergency management activity, for a safer Australia; and
- assisting Territories to manage their own futures. The Australian Government, through AGD, administers the Territories of the Ashmore and Cartier Islands, Christmas Island, the Cocos (Keeling) Islands, the Coral Sea Islands and Jervis Bay; and manages national interests in the Australian Capital Territory, the Northern Territory and Norfolk Island.

**4.21** In 2009–10 AGD has identified the following priority areas:

- National security: with a focus on improving national security legislation, enhancing and better coordinating emergency management and disaster resilience, and countering violent extremism and organised crime.
- Access to justice: including the development and implementation of alternatives to litigation and the promotion of an effective legal assistance scheme.
- Human rights: with a focus on progressing national human rights and Australia becoming party to international human rights instruments.
- Family law: reducing the cost of family law and shifting the focus to early dispute resolution, and working closely with the states and territories to address family violence.
- Native title: improving the operation of the native title system and the outcomes that can be achieved under it.

- Harmonisation of laws: pursuing the harmonisation of laws, including reforms on personal property securities.
- Territories: ensuring the residents of Australian's external territories have access to the same rights, protections and essential services enjoyed by other Australian communities.

**4.22** The key characteristics of AGD's business operations that shape the 2009–10 financial statement audit coverage include:

- the growth and evolving nature of AGD's responsibilities;
- new IT systems that interface with the financial management information system and the human resource management information system;
- the geographical spread of AGD's asset base; and
- the overall effectiveness of AGD's internal control systems.

**4.23** It is noted that responsibility for Judges' Pension entitlements was transferred to the Department of Finance and Deregulation from 31 December 2009.

## Financial overview

**4.24** AGD's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2009–10</b>	<b>Departmental Actual (\$m) 2008–09</b>	<b>Administered Estimated (\$m) 2009–10</b>	<b>Administered Actual (\$m) 2008–09</b>
Net cost of services	237	235		
Appropriation revenue	237	234		
Administered income			40	48
Administered expenses			617*	847
Total assets	253	246	850	813
Total liabilities	77	78	94**	728

\*The decrease in administered expenses reflects the transfer of responsibility for both state based grants (natural disaster and legal aid) to Treasury, and for the payment of judges' pensions to the Department of Finance and Deregulation.

\*\*The significant decrease in administered liabilities also reflects the transfer of judges' pension entitlements to the Department of Finance and Deregulation.

AGD's estimated average staffing level for 2009–10 is 1 404 (2008–09 : 1 479).

## **Governance arrangements**

**4.25** AGD has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of AGD's business objectives. These arrangements support the achievement of AGD's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**4.26** The key elements of the AGD's arrangements include:

- a strategic plan that provides an overview of AGD's strategic priorities and goals, including AGD's planning and performance framework;
- the Secretary's Leadership Group that meets regularly to consider key strategic matters of corporate importance and set AGD's strategic direction. The group comprises the Secretary and the three Deputy Secretaries;
- the Departmental Operations Executive Committee that fosters strategic debate on a range of issues of corporate importance. The committee comprises the department's three Deputy Secretaries and all First Assistant Secretaries;
- an audit committee that meets quarterly and is chaired by an external member. The audit committee is responsible for oversight of the department's approach to risk management, including AGD's overall control framework and internal audit function;
- an internal audit unit that develops an internal audit strategy and plan that addresses key business and financial risks;
- a risk management framework and risk management plan that addresses a broad range of operational risks; and
- a fraud control plan that is updated and reviewed in line with the Commonwealth Fraud Control Guidelines.

## **Areas of audit focus**

**4.27** In the light of the ANAO's understanding of AGD's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on AGD's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- the mid-year valuation of the Judges' Pension provision and subsequent transfer of the Judges Pension Scheme to the Department of Finance and Deregulation; and
- two new IT systems, being the new billing system, OBS, and the new timesheet system, Timekeeper.

**4.28** We will continue to provide audit coverage of the following areas which have been identified in previous years:

- key financial statement items that rely on estimated future indices including employee provisions and concessional loans. The assessment of future salary growth rates and the resultant impact on employee provisions will also be reviewed; and
- the development and capitalisation of intangibles, in particular the Personal Properties Security Register software application.

**4.29** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.30** The ANAO has assessed the overall risk of material misstatement in the 2009–10 financial statements as low.

## **Audit results**

**4.31** The ANAO has completed initial internal control assurance work relating to the new IT systems and the capitalisation of intangibles. No significant or moderate issues have been identified to date. This work will be completed as part of the 2009–10 final audit. The remaining areas of audit focus will be reviewed as part of the final audit.

**4.32** The following table provides a summary of the status of issues identified by the ANAO in the prior year.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	3	(1)	1	3	(2)	0	1
<b>Total</b>	<b>3</b>	<b>(1)</b>	<b>1</b>	<b>3</b>	<b>(2)</b>	<b>0</b>	<b>1</b>

### *Prior year moderate audit issues*

4.33 The ANAO reported three moderate control weaknesses during the 2008–09 audit.<sup>33</sup> These issues related to:

- Assets Under Construction—delays in capitalising the cost of completed projects and lack of formal procedures to regularly monitor and validate recorded balances;
- IT security—weaknesses in access management practices for AGD’s human resource management information system; and
- stocktaking issues—weaknesses in the stocktake control and oversight procedures, poor quality review of the returned count sheets, and weaknesses in the documentation of stocktake results and associated follow-up activities.

4.34 The 2009–10 interim audit found that formal procedures had been implemented to regularly monitor and review the assets under construction balance. These procedures are designed to ensure that costs associated with completed projects are correctly capitalised in a timely manner. The ANAO is satisfied that this issue has now been resolved.

4.35 During the 2009–10 interim audit the ANAO also identified that significant work had been undertaken to address IT security weaknesses in relation to AGD’s human resource management information system. This has resulted in the audit finding being downgraded from a moderate to a minor

<sup>33</sup> The results of our 2008–09 interim audits were reported in ANAO Audit Report No 42 *Interim Phase of the Audit of Financial Statements of General Government Sector Agencies for the Year ending 30 June 2009*.



audit issue, with full resolution being dependent on the completion of two minor remedial steps.

**4.36** The interim audit identified that improved stocktake processes had been implemented. However, as AGD had not completed the annual stocktake at the time of the 2009–10 interim audit, this finding could not be fully reviewed. The ANAO will complete its review of this issue as part of the 2009–10 final audit.

## **Conclusion**

**4.37** Based on the audit work performed to date, key internal controls are assessed as operating satisfactorily and provide reasonable assurance that the department should be able to prepare financial statements that are free of material misstatement.

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

**4.38** The role of the Australian Customs and Border Protection Service (Customs and Border Protection) is to protect the safety, security and commercial interests of Australians through border protection designed to support legitimate trade and travel. In this role, Customs and Border Protection administers trade measures and certain government industry schemes as well as collecting trade statistics. The collection of border-related revenue such as customs duty, passenger movement charges and the import processing and depot charges is also undertaken, as is the assessment and collection, where appropriate, of Goods and Services Tax (GST) on imported goods, 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.

**4.39** Border Protection Command, which is a Customs and Border Protection and Department of Defence joint command, provides security for Australia's offshore maritime areas. In 2009–10 Customs and Border Protection received additional funding to support the commitment to respond to the rise in maritime people smuggling activities.

**4.40** The key characteristics of Customs and Border Protection's operations that shaped the planned 2009–10 financial statement audit coverage include:

- the self-assessment nature of customs duty and the complexity of the IT infrastructure facilitating the collection of duty and other border related revenue;
- the significant amount of customs duty and GST revenue collected; and
- the large number and value of assets controlled by Customs and Border Protection in undertaking their activities.

## Financial overview

4.41 Customs and Border Protection's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	1 028	1 021		
Appropriation revenue	1 028	1 009		
Administered income			6 516	6 921
Administered expenses			4	14
Total assets	643	634	132	119
Total liabilities	238	235	8	8

Customs and Border Protection's estimated average staffing level for 2009–10 is 5 500 (2008–09 : 5 679).

## Governance arrangements

4.42 The ANAO's audit approach considers Customs and Border Protection's corporate governance structure. The key elements of this structure that contribute to good governance arrangements by Customs and Border Protection include:

- a monthly Executive meeting to evaluate performance, complemented by a bi-annual meeting of senior executives from central and regional offices to discuss strategic management issues and future directions;
- an audit committee, with 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;

- the preparation of annual and corporate operational plans that identify major processes and risks which flow from the strategic outlook;
- a Customs and Border Protection Practice Statement Program which is used to define and implement the agency's national policies;
- a risk management policy that documents how risk assessments are developed and monitored; and
- a Fraud Control Committee that meets quarterly and oversees a fraud awareness program.

### **Areas of audit focus**

**4.43** The audit approach is shaped by our understanding of Customs and Border Protection's operating environment, the associated risks arising from that environment relevant to the financial statements, and the internal control framework in place to mitigate those risks.

**4.44** In 2009–10 the main areas of audit focus are:

- the accuracy and completeness of customs duty and other border related revenue in the light of the self-assessment nature of customs duty, the complexity of the IT infrastructure used to collect and record customs duty and the complexity of tariffs and concession entitlements. There were also significant changes to tariff rates effective from 1 January 2010, including changes in duty rates for passenger motor vehicles and components, and textile, clothing and footwear goods; and
- the accuracy of Customs and Border Protection's assets register in the light of previous years' audit findings that, for a number of assets, the location recorded in the asset register was not correct.

**4.45** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.46** The ANAO has assessed the risk of material misstatement in the 2009–10 Customs and Border Protection's financial statements as moderate.

## Audit results

4.47 The ANAO has directed the focus of the interim audit to the two areas referred to above. In relation to the accuracy and completeness of customs duty and other border related revenue, the ANAO has undertaken a review of general IT controls and the management of selected administered revenue, including the Passenger Movement Charge. The work undertaken identified issues, set out below, relating to the management of administered receivables, the Passenger Movement Charge, the documentation of the financial statement process and IT security controls. The ANAO will review selected key controls within the cargo management system, the Integrated Cargo System (ICS), prior to year end.

4.48 The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	3	0	0	3	(2*)	3	4
<b>Total</b>	<b>3</b>	<b>0</b>	<b>0</b>	<b>3</b>	<b>(2)</b>	<b>3</b>	<b>4</b>

\*Two Category B findings have been reassessed to Category C findings.

### Moderate audit issues—Category B

#### New moderate audit issues

#### Management of administered receivables

4.49 Customs and Border Protection does not have a centralised administered receivables system to ensure that these receivables are recognised and consistently managed. As a result, data on administered receivables is only collated and measured at year end as part of the financial statements preparation process. The sources of potential administered receivables are spread throughout the operations of Customs and Border Protection as well as being geographically spread across Australia. Without a centralised administered receivables system in place, there is an increased risk that these

receivables will not be appropriately recognised and consistently followed up in a timely manner. There is also an increased risk that administered receivables may not be captured where there is a timing difference between import or export transactions occurring and the input of the transactions into the cargo management system. This could particularly be the case when the transactions are complex or are subject to amendment.

#### Passenger Movement Charge

**4.50** The Passenger Movement Charge (PMC) is a charge levied on each departing passenger from Australia. Customs and Border Protection reports PMC revenue of approximately \$500 million as administered revenue in its financial statements. It is applied and collected by airline carriers under the *Passenger Movement Charge Act 1978* and the *Passenger Charge Collection Act 1978*. Our 2009–10 interim audit identified a number of weaknesses in the management of PMC, including a lack of analysis related to a threshold used to assess variances between amounts estimated to be received by Customs and Border Protection and the amounts actually remitted by carriers. The ANAO also identified that audit activity had not been undertaken in accordance with Customs and Border Protection's policies and procedures. Customs and Border Protection has advised that it is reviewing its management of PMC.

#### Documentation of Financial Statement Processes

**4.51** Customs and Border Protection's administered financial statements are based on complex transactions. There are, however, no documented procedures to assist staff in the preparation of the administered statements and describe the flow of administered transactions through Customs and Border Protection's operations. Without documented procedures, there is an increased risk that the financial statements will not be complete and accurate, or there may be delays in the preparation of the financial statements. Customs and Border Protection advised it was preparing procedures relating to the preparation of its administered financial statements in conjunction with internal audit.

#### *Prior year audit issues*

##### IT Security Controls

**4.52** The 2008–09 audit identified a number of weaknesses in the management of Customs and Border Protection's IT Security Policy, including insufficient complexity of passwords, lack of monitoring of privileged users and instances where there was inappropriate approval of new users. In

2009–10, Customs and Border Protection undertook an internal audit of its user access management that identified weaknesses still existed. The internal audit also identified issues with the ICS user access management and processes for removing ICS and LAN access from terminated staff. These weaknesses increase the risk of system compromise and may lead to unauthorised and inappropriate access to financial systems. The ANAO has recommended that Customs and Border Protection review and update its user access management processes to help ensure system access is appropriately approved, commensurate with staff roles, and is removed in a timely manner when a staff member departs or their role changes.

#### *Prior year audit issues downgraded*

##### IT Change Management Processes

**4.53** In 2008–09, the ANAO raised a number of issues relating to change management practices, including a lack of documentation of system changes. Our 2009–10 interim audit identified that Customs and Border Protection has taken action to partially resolve these issues, resulting in the ANAO downgrading this finding to a Category C finding.

##### Asset Management

**4.54** Customs and Border Protection manages physical assets, including infrastructure, plant and equipment valued at approximately \$130 million. In 2007–08 and 2008–09 the ANAO identified that for a number of assets the location recorded in the asset register was not correct. Our 2009–10 interim audit identified that there was a significant improvement in the recording of the location of assets as a result of enhanced stock taking processes. However, the ANAO considered that Customs and Border Protection could improve its policies and processes for recording certain types of assets. As a result of the improvements noted, the ANAO has downgraded this finding to a Category C finding.

## **Conclusion**

**4.55** 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 as designed. 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

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## Department of Broadband, Communications and the Digital Economy

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

**4.57** The key characteristics of DBCDE's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- a legislative environment that is subject to ongoing change;
- the significance of administered activities including programs such as the Australian Broadband Guarantee; and
- the significant administered asset balances reported in the department's financial statements, particularly the Australian Government's investments in portfolio agencies.

## Financial overview

4.58 DBCDE's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	154	113		
Appropriation revenue	154	117		
Administered income			173	516
Administered expenses			1 325	1 236
Total assets	80	100	3 986	3 641
Total liabilities	27	27	11	23

The DBCDE's estimated average staffing level for 2009–10 is 643 (2008–09 : 635).

## Governance arrangements

4.59 DBCDE's corporate governance arrangements and financial reporting framework are key factors for consideration by the ANAO in undertaking the financial statement audit of the department. DBCDE's management has recently reviewed and improved elements of its corporate governance arrangements. The department's governance arrangements, along with its financial reporting framework assist in providing reasonable assurance about the achievement of DBCDE's strategic objectives, financial reporting requirements and compliance with relevant legislative requirements.

4.60 The key elements of DBCDE's arrangements include:

- an executive management group which 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;
- a performance reporting committee that meets monthly and oversees the performance of each of the department's major departmental programs and administered expense items;
- an audit committee that meets at least five times a year and focuses attention on internal controls, internal and external audit activity, management of risks, review of financial reports, control of public monies, fraud control, and regulatory compliance;



- an internal audit function that undertakes a risk-based audit coverage of DBCDE's activities;
- fraud control and risk management plans that are regularly monitored and updated;
- integrated strategic and business planning and internal budgeting; and
- 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.

## Areas of audit focus

**4.61** In the light of the ANAO's understanding of DBCDE's environment and governance arrangements that include a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact DBCDE's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- administered grants and subsidies expenses. This includes subsidy programs such as the Australian Broadband Guarantee; and
- the valuation of the Australian Postal Corporation that is recognised as an administered investment in DBCDE's financial statements.

**4.62** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.63** The ANAO has assessed the overall risk of material misstatement in the 2009–10 financial statements as low.

## Audit results

**4.64** The ANAO has completed its interim audit coverage to assess the effectiveness of controls in the areas which have been identified as significant to the financial statements, including administered grants and subsidies. The audit identified a moderate audit issue relating to user access that is outlined below. The remaining areas of audit focus relate to work that will be undertaken as part of the 2009–10 final audit.

4.65 The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the 2009–10 interim audit.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>

#### *Moderate audit issue—Category B*

##### User access to the FMIS

4.66 The 2009–10 interim audit identified that the FMIS had generic system support accounts which gave access to the production environment, without leaving an audit trail that allows individual users to be identified. By using these generic system support accounts, system support users may be able to by-pass all controls surrounding the segregation of duties within the system. This weakness increases the risk of unauthorised system changes that could compromise the confidentiality, integrity and completeness of financial data within the FMIS.

### Conclusion

4.67 The ANAO found that, with the exception of the issue mentioned above, key elements of internal control were operating effectively to provide reasonable assurance that DBCDE can prepare financial statements that are free of material misstatement. The effective operation of internal controls for the full financial year will be assessed during the 2009–10 final audit.

# Climate Change and Energy Efficiency Portfolio

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## Department of Climate Change and Energy Efficiency

**4.68** The Department of Climate Change and Energy Efficiency (DCCEE) is responsible for policy advice, policy implementation and program delivery in the areas of climate change and energy efficiency.

**4.69** DCCEE's business operations include:

- development and implementation of climate change and energy efficiency policy and programs;
- implementation of the National Greenhouse and Energy Reporting System and continuing development of the Greenhouse and Energy Reporting Office;
- contributing to the development of an effective global response to climate change; and
- working with industry, business and the community across Australia to improve energy efficiency and reduce greenhouse gas emissions.

**4.70** The key characteristic of DCCEE's business operations that shape the ANAO's 2009–10 financial statement audit coverage is the impact of the transfer of the energy efficiency function from the Department of the Environment, Water, Heritage and the Arts (DEWHA). This transfer took effect on 8 March 2010.

## Financial overview

4.71 DCCEE's key financial figures are:

Key financial balances	Departmental	Departmental	Administered*	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	116	85		
Appropriation revenue	116	79		
Administered income			-	0
Administered expenses			713 *	38
Total assets	84	46	-	0
Total liabilities	30	33	2	2

\*The significant increase in administered expenses reflects the transfer of the energy efficiency function to the department.

DCCEE's estimated average staffing level for 2009–10 is 640 (2008–09 : 302).

## Governance arrangements

4.72 DCCEE has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DCCEE's business objectives. These arrangements support the achievement of DCCEE's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.73 The key elements of the DCCEE's arrangements include:

- a strategic business plan that provides an overview of DCCEE's directions for the future, including corporate outcomes and performance measures;
- a financial reporting framework, including chief executive instructions endorsed by the audit committee;
- an executive board that meets fortnightly to consider the key strategic operational and system requirements of the department;
- certificate of compliance reviews by the legal and procurement team;
- a governance committee framework, including an audit committee that meets at least quarterly; and

- 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.

4.74 DCCEE reviewed its governance arrangements as a result of the transfer of the energy efficiency programs and are in the process of making some changes. The effect of these changes will be reviewed during the 2009–10 final audit.

### **Areas of audit focus**

4.75 In the light of the ANAO's understanding of DCCEE's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact DCCEE's financial statements. The transfer of the energy efficiency function to the department and the accounting issues associated with the Home Insulation Program have been highlighted as areas for specific audit coverage in 2009–10.

4.76 We will continue to examine DCCEE's structure of internal control which is designed to ensure adequate risk mitigation strategies over financial transactions are implemented and effective for the whole financial year.

4.77 As outlined in Chapter 3, the ANAO also reviews agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

4.78 The ANAO has assessed the risk of material misstatement in the 2009–10 DCCEE financial statements as moderate. This rating reflects the increased risks associated with the new functions transferred to the department during the year.

### **Audit results**

4.79 In view of the timing of the transfer of the energy efficiency programs from DEWHA to DCCEE, the ANAO's review of these programs will be undertaken as part of the 2009–10 final audit. The audit work related to internal controls over other significant financial transactions has not identified any significant or moderate audit issues.

## **Conclusion**

**4.80** The ANAO's audit coverage of the Energy Efficiency Program, transferred to the department in March 2010, will be undertaken as part of our 2009–10 final audit. This work will enable the ANAO to complete its assessment of the key controls that support the preparation of the department's 2009–10 financial statements.

# Defence Portfolio

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## Department of Defence

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

**4.82** Defence is responsible for delivering three outcomes:

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

**4.83** Defence's key initiatives in 2009–10 are the implementation of the Defence White Paper, *Defending Australia in the Asia Pacific Century: Force 2030*. The White Paper, released in May 2009, articulates the Government's policy, capability and funding settings for Defence for the period to 2030.

**4.84** The key characteristics of Defence's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- a complex and diversified business structure which has a significant geographical spread both nationally and overseas, and is governed by an operational tempo that demands expert capability to deploy resources efficiently;
- the complex and dispersed nature of Defence's operations which comprises logistics and asset management, storage and distribution, significant property estate management, technology research and development, and project management in specialised fields;
- the material and varied nature of assets managed by Defence, such as, specialised military equipment, land and buildings, and heritage and cultural assets. Complexity also results from the accounting for and the valuation of these assets; and changes in the control environment affected by the implementation, on 1 July 2010, of a replacement inventory and asset management system;
- the potential impact of Defence's program of savings and reinvestment (the Strategic Reform Program) on the internal controls supporting the financial statements; and
- a complex financial statement process that involves using data from numerous business systems, and involves significant estimation in the calculation of a number of balances.



## Financial overview

4.85 Defence's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	21 924	21 211		
Appropriation revenue	21 924	20 268		
Administered income			1 027	917
Administered expenses			3 502	3 501
Total assets	64 138	61 348	2 448	2 032
Total liabilities	4 931	4 642	41 971	42 697

Defence's estimated average staffing level for 2009–10 is 94 671 : 57 777 permanent forces, 21 574 reserves, 14 622 civilian staff and 698 professional service providers. (2008–09 : 90 231 comprising 55 118 permanent forces, 20 026 reserves, 14 534 civilian staff and 553 professional service providers.)

## Governance arrangements

4.86 Defence's management has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Defence's business objectives. These arrangements support the achievement of Defence's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.87 The key elements of Defence's governance arrangements include:

- dual chief executive officers, the Secretary and the Chief of the Defence Force, that are guided by a joint Ministerial directive detailing the expectations of the Minister and providing guidance on accountability;
- the Defence Committee, which is chaired by the Secretary, is the primary advisory body within Defence supporting the Secretary and the Chief of the Defence Force (CDF) in meeting their joint responsibilities;
- the Chiefs of Service Committee, which is 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;

- a governance committee framework, including the Defence Audit and Risk Committee (DARC) and the Workforce and Financial Management Committee;
- an internal audit function, which performs a range of internal audits across Defence and the Defence Materiel Organisation (DMO) (a major provider of goods and services to Defence) and reports findings to the DARC and the Defence Executive;
- the Defence enterprise risk management plan, risk profile, and a risk tolerance statement which is an ongoing project that commenced in 2008–09;
- a Strategic Reform Program designed to realise \$20bn gross savings over the coming decade, improve strategic and corporate level planning, and achieve greater budget transparency; and
- a Financial Policy, Controls and Skills Branch which is responsible for documenting financial management risks, controls and processes, and assigning accountability for effective operation and monitoring of financial controls.

## Areas of audit focus

**4.88** Given the ANAO's understanding of Defence and its environment and governance arrangements, the audit approach has identified a number of continuing and emerging areas of focus for our audit of Defence's financial statements in 2009–10:

- Inventory and Asset Management, in particular General Stores and Repairable Items, and Explosive Ordnance inventory; Special Military Equipment (SME); and General Assets. Due to the material nature of asset balances and the inherent risks identified by both Defence and the ANAO, the existence, valuation and impairment of inventory and assets continues to require significant audit examination.
- The major project, *Logistics for the Warfighter* (JP2077), which includes the Military Inventory and Logistics Information System (MILIS) and the Materiel Logistics Financial Framework (MLFF). MILIS is Defence's newly developed inventory and asset management system initially programmed to 'go live' in October 2009 (now scheduled for 1 July 2010). The implementation of this project affects the timing and the level of assurance the ANAO can obtain over the internal controls

supporting inventory and assets balances and the assessed risks to the financial statements associated with implementation of MILIS. Risks arise from:

- reduced assurance over the year-end inventory balance due to stock-take activity being unable to be performed in the last quarter of 2009–10 as a consequence of the level of implementation activities and training associated with the MILIS;
- the transfer of material inventory balances, currently managed in the Standard Defence Supply System (SDSS), into the MILIS (approximately 16 million transactions per year);
- ongoing SDSS data cleansing intended to remediate the historical data issues in SDSS (previously resulted in significant and moderate audit findings) and prepare for the data transfer to MILIS;
- the update and re-design of business processes and controls within and surrounding MILIS, including interfaces to existing financial systems; and
- the inherent risks associated with the implementation of new systems such as; system and user security, obtaining system accreditation, project governance, testing strategies, contingency planning and system acceptance.

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

- remediation activity to address weaknesses in the Financial Management Framework;
- Bureau Service arrangements between Defence and DMO, specifically the oversight of DMO expenditure made on behalf of Defence including the ongoing issues identified in the ANAO's Audit Report 2009–10 No.24 *Procurement of Explosive Ordnance for the Australian Defence Force*;
- Defence's control environment and management of the complex and diversified HR management systems that operate in a number of locations nationally and overseas;

- the complex estimation and allocation processes associated with a number of balances in Defence's financial statements, including provisions for decommissioning of SME, decontamination and restoration of the vast number of Defence sites both nationally and overseas; and
- Defence's 'Purchase to Pay' operations that include a number of management systems, processes and security protocols.

**4.90** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.91** The ANAO has assessed the risk of material misstatement in the 2009–10 Defence financial statements as high.

## **Audit results**

**4.92** Our interim audit coverage has focused primarily on Inventory and Asset management which has involved resource intensive testing of assets and financial transactions. Other activity has included coverage of Defence's 'Purchase to Pay' operations and HR management systems. The ANAO has also commenced audit coverage of the Financial Reporting Framework and the MILIS but work in these areas will not be completed until the final audit.

**4.93** Our audit of the Inventory and Assets control activities and stock holdings at Defence and contractor sites, continues to identify weaknesses. Accordingly, the significant finding (Category A) relating to the *General Stores Inventory and Repairable Items: Quantities* is unresolved and continues to be the focus of considerable remediation activity by Defence. Defence has advised that the necessary remediation activities will not be finalised in the current financial year. Coverage of these matters will be included as part of the 2009–10 final audit.

**4.94** The other areas of audit focus will also be examined as part of the final audit.

**4.95** The following table provides a summary of the status of prior year audit issues as well as the 2009–10 audit issues raised by the ANAO during the interim phase of the audit.

## Status of audit issues raised by the ANAO

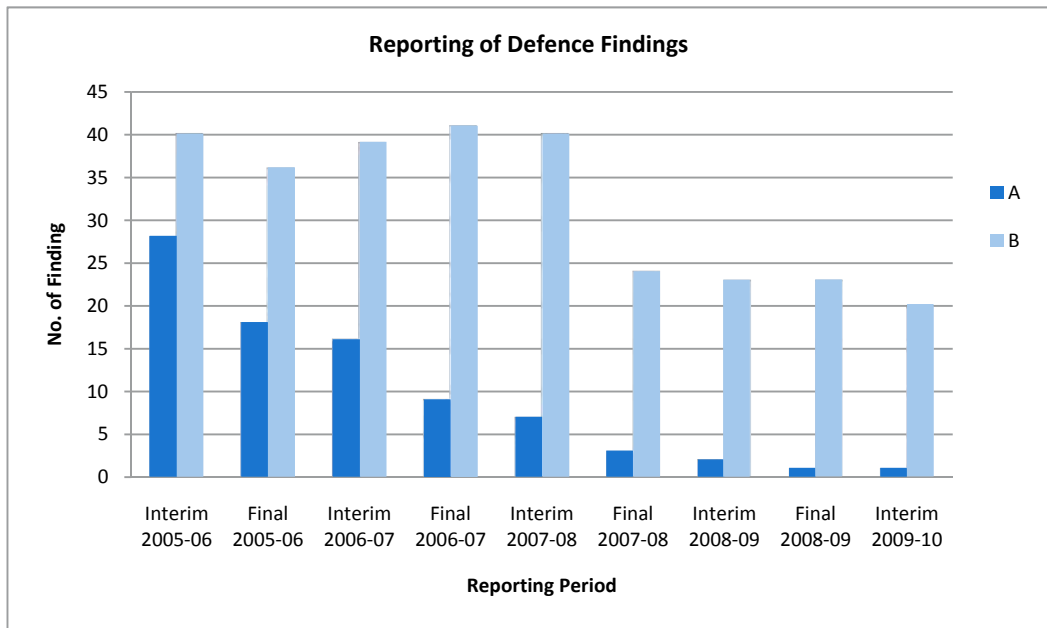
Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	2	(2)	1	1	0	0	1
B	23	(14)	14	23	(4)	1	20
<b>Total</b>	<b>25</b>	<b>(16)</b>	<b>15</b>	<b>24</b>	<b>(4)</b>	<b>1</b>	<b>21</b>

**4.96** The 2009–10 interim audit identified one new moderate audit finding relating to business continuity planning, as detailed at paragraph 4.115 below.

**4.97** In addition, Defence resolved four moderate risk findings associated with Information Technology. The resolved findings related to the currency of IT strategic planning documentation, the management of certain controls within SDSS, and user access management and change management of the Invoice Scanning and Imaging System <sup>34</sup> (ISIS).

**4.98** The following graph illustrates the number of significant (Category A) and moderate (Category B) findings reported, by audit phase, for the audit of Defence’s financial statements over the last five years. The graph highlights a downward trend in the number and severity of findings since 2005–06 as a result of Defence’s ongoing remediation program and management focus on the financial controls framework. This reflects well on the department’s remedial efforts. To ensure the successful remediation of the remaining findings and continuation of Defence’s successes, long-term focus on previously remediated issues with respect to the internal control environment is needed.

<sup>34</sup> 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.



## Audit Findings

### Logistics Management General Stores Inventory (GSI)

**4.99** Consistent with prior years, Defence and the ANAO continue to perform resource intensive activities to gain assurance that the inventory balances are materially correct. The ANAO activities include an extensive review of the progress of the remediation activities undertaken by Defence and the DMO to address GSI quantities and legacy pricing issues.

**4.100** At the completion of the 2008–09 audit a number of significant and moderate rated issues remained outstanding in relation to a need to:

- strengthen controls, documentation and the reporting of the cyclical stock-take program of inventory and assets;
- address deficiencies in the underlying controls that affect the quality of data within the inventory system (SDSS);
- improve the analysis and management of variances from the reconciliation of the SDSS and the financial management information system (ROMAN);
- improve the currency and alignment of policies and procedures to the supply chain processes used within Defence establishments and

increase the awareness of changes to specific policies and processes within these establishments;

- improve management assurance activities supporting supply chain processes;
- strengthen controls over the pricing of general stores inventory;
- improve the retention of supporting documentation relating to the approval to dispose of certain Defence assets; and
- strengthen the estimation processes for obsolete inventory items.

**4.101** Defence's 2009–10 'Multilayered Inventory Assurance Strategy', continues to focus on business process improvement, including the validation of controls over the supply chain systems and processes, stocktaking activities and price record assurance.

**4.102** Notwithstanding the above, the continued risks associated with Defence's purchase, and management of, assets and inventory reduces the ANAO's ability to place reliance on specific inventory management and purchasing controls for 2009–10. Accordingly, the ANAO continues to focus on validating the effectiveness of Defence's Multilayered Inventory Assurance Strategy and is conducting extended detailed transaction testing at Defence establishments across Australia to gain reasonable assurance in relation to the financial statement items.

**4.103** Defence has reported that the necessary remediation activities will not be resolved in the current financial year.

#### Financial Management Framework

**4.104** 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 2008–09 audit, the ANAO reported two moderate issues in relation to the framework. These were:

- a need for greater management and oversight of arrangements between DMO and Defence; and
- deficiencies in the bureau service arrangements relating to the supply chain systems and processes.

**4.105** These issues remained outstanding at the completion of the 2009–10 interim audit.

## Financial Management Information System

**4.106** In 2008–09, the ANAO reported user access management issues associated with users having the ability to perform financial transaction or system functions that should be separated, a high number of users with access to sensitive financial transactions and weaknesses in relation to configuration settings within the Financial Management Information System. Defence has advised that remedial action has now been completed. The ANAO will review this matter as part of the 2009–10 final audit.

### Purchase to Pay

**4.107** In 2008–09, the ANAO reported control weaknesses in the purchasing and payment systems, and business processes known as ‘Purchase to Pay’. These issues related to accounts payable management, the Card Management System<sup>35</sup> (CMS), the Master Supplier Register<sup>36</sup> (MSR) and the ISIS System, and included 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.

**4.108** In 2009–10, Defence has appropriately remediated the issues associated with procurement delegation and approval procedures and the MSR and ISIS IT general control issues. The control weakness associated with vendor records and purchase and travel cards remains outstanding.

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<sup>35</sup> The Card Management System is the system used to manage Defence’s corporate credit card transactions.

<sup>36</sup> The Master Supplier Register is Defence’s single authoritative source for vendor related data.



**4.109** The extent of these issues continues to limit 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 2009–10 audit.

#### Human Resource Management

**4.110** The Human Resource 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 conclusion of the 2008–09 audit, the ANAO reported the following issues:

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

**4.111** Defence has advised that the reconciliation between PMKeyS and ADFPay has been completed. The ANAO will review this issue during the 2009–10 final audit.

**4.112** The remaining issues remained outstanding at the completion of the interim phase of the 2009–10 audit.

#### IT Governance

**4.113** Defence has implemented a number of strategic reforms in relation to Information and Communications Technology. The scope of the financial statement audit is focused on factors which have a direct bearing on Defence's financial statements.

**4.114** In 2008–09, the ANAO reported a moderate audit issue in relation to the currency of key IT strategic planning documentation. This issue has now been resolved with the development and formal release of the IT strategic plan.

**4.115** In 2009–10 the ANAO reported one new moderate audit issue in relation to Business Continuity Management within Defence. The ANAO's testing of Defence's multilevel Business Continuity approach identified that:

- group level Business Impact Analysis (BIA) had not been completed;
- business continuity planning requirements needed to be completed based on the BIA and endorsed; and
- specific key Business Continuity Plans (BCPs) were unavailable for review by the ANAO.

**4.116** Defence has advised the ANAO that it is undertaking an extensive project with respect to business continuity including the preparation of BIAs by group and BCP's. Defence expects this to be completed by July 2011.

#### Asset Management

**4.117** Defence's assets are significant and varied, and are managed over a diverse geographical range. At the completion of the 2008–09 audit, the ANAO reported two moderate issues in relation to asset management:

- Assets Under Construction (AUC) – non specialised military equipment: improving procedural documentation and controls over the rollout of AUC, particularly the identification and recording of assets rolled out and in use, and recorded in the Fixed Asset Register (FAR); and
- Specialist Military Assets – improving controls surrounding certain Specialist Military Assets to ensure that sufficient documentation exists to identify the location of the asset, records of mandatory accounting information relating to these assets is maintained, and reasonable measures are implemented to ensure cyclical verification of the existence of these assets.

**4.118** The ANAO is finalising its review in this area and the results will be reported as part of the 2009–10 final audit.

### Conclusion

**4.119** Defence's remediation activities have resulted in an improvement in the number and severity of audit findings. The heightened state of reform within Defence, coupled with the implementation of key systems, will present challenges in maintaining a Portfolio-wide (including DMO) focus on remediation activities and the implementation and ongoing monitoring and maintenance of control activities in this reform environment.

## Defence Materiel Organisation

**4.120** The Defence Materiel Organisation (DMO) is the primary service delivery agency responsible for buying and maintaining equipment for the Australian Defence Force (ADF) and supporting ADF capabilities through the deployment of specialist staff. The DMO also provides industry and procurement policy and advice to the Department of Defence (Defence) and the Australian Government.

**4.121** The DMO employs staff in 40 locations within Australia and overseas. It budgets for a break even operating result. This budgeted operating result reflects the DMO's funding model where it is funded for the activities it performs. These activities and objectives are principally determined by objectives set by the Australian Government, Defence policies and the operational requirements of the ADF.

**4.122** The DMO receives the majority of its funding from Defence and operates under purchase-provider arrangements established with Defence. The funding arrangements are formalised in agreements covering key operational areas including acquisition, sustainment, military workforce and shared services. Commencing from 2009–10 the DMO will receive a direct appropriation for the element of its workforce and operating expenses previously paid for by Defence as a service fee in accordance with the Materiel Acquisition Agreements (MAA) and Materiel Sustainment Agreements (MSA). As a result of this new arrangement, revenue from government for the 2009–10 financial year is estimated to increase by some \$805 million to \$901 million.

**4.123** The key characteristics of DMO's business operations that shape the ANAO's financial statement audit coverage include:

- DMO's diversified corporate and project management IT applications that operate in a number of locations nationally and overseas;
- the number of very significant financial statement balances including Cost of Goods Sold to Defence and Repairs and Overhaul;
- changes in the control environment affected by the preparation for a replacement inventory asset management system, referred to in paragraph 4.88 above;
- the potential impact of the Strategic Reform Program (SRP), referred to at paragraph 4.87 above, on DMO's control environment supporting its financial statements; and

- a complex financial statement process that involves using data from numerous business systems and processes, and involving significant estimation in the calculation of a number of balances.

## Financial Overview

4.124 The DMO's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	901	24		
Appropriation revenue	901*	95		
Administered income			7	8
Administered expenses				
Total assets	1 980	1 967		
Total liabilities	1 669	1 655		

\* From 2009–10 the DMO receives a direct appropriation for the service fee previously funded in accordance with the Materiel Acquisition Agreements (MAA) and Materiel Sustainment Agreements (MSA)

The DMO's total estimated average staffing level is 5 632 (2008–09: 5 552).

## Governance arrangements

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

4.126 The key elements of DMO's governance arrangements include:

- a Material Audit and Risk Committee (MARC). The MARC is comprised of three independent members and formally meets six to seven times per year. The MARC oversees the preparation of the financial statements prior to their signing. It formally reports to the CEO annually on matters relating to the governance framework, including:
  - enterprise risk management;

- the efficiency and effectiveness of the existing acquisition and sustainment and financial control frameworks;
  - external accountability;
  - legislative compliance;
  - internal and external audit; and
  - an internal audit function, managed by the Chief Audit Executive. The internal audit function is supervised by the MARC and delivered by Defence’s Management Audit Division and DMO’s contract internal auditors.
- an Assurance Rationalisation Program, managed by the Director-General Governance and Assurance, that is designed to ensure the internal assurance program is appropriate and focused on key risk areas;
  - 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;
  - Fraud Control Plans supported by fraud risk assessments, an ethics awareness policy, training and Chief Executive Instructions (CEI) on Fraud Control;
  - a range of boards designed to ensure the continuing accountability of the DMO, including:
    - the Defence Strategic Reform Advisory Board (DSRAB), established to oversee the broader SRP in Defence and comprising public sector officials, independent members, the CEO DMO, and the chair of the MARC (observer);
    - Gate Review Assurance Boards that conduct formal project reviews before selected key project milestones with the aim of assuring a project’s status and prospects of achieving the capability required; and
    - Project Manager Stakeholder Groups that regularly review the status and progress of major acquisition projects.

- regular management reports to the CEO that detail the delivery of Defence acquisition and sustainment that are also provided on a monthly basis to Defence and central agencies.

### **Areas of audit focus**

**4.127** Given the ANAO's understanding of the DMO and its environment and governance arrangements, the audit approach has identified a number of continuing and emerging areas of audit focus that have the potential to significantly affect on DMO's financial statements. The following areas have been highlighted for specific audit coverage in 2009–10:

- the IT applications, ROMAN, SDSS and PMKeys, and their related processes that are used in the preparation of key financial information across DMO's acquisition, sustainment and corporate activities;
- service delivery arrangements between the DMO and Defence affecting: the IT general control environment; key financial information systems; personnel management; and year-end financial reporting processes;
- ongoing system and data integrity issues within the Standard Defence Supply System (SDSS) which is the key operational information system used to record and report inventory and repairable items purchased on behalf of Defence;
- remediation activity to address weaknesses in the financial controls framework and associated assurance activities; and
- issues relating to the accuracy and completeness of the recording and reporting of financial commitments.

**4.128** The ANAO has assessed the risk of material misstatement in the 2009–10 DMO's financial statements as moderate.

### **Audit results**

**4.129** The following table provides a summary of the status of prior year issues as well as 2009–10 audit issues raised by the ANAO.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	Issues Reclassified	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (as part of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0	0
B	12	(8)*	1**	2	7	0	0	7
<b>TOTAL</b>	<b>12</b>	<b>(8)</b>	<b>1</b>	<b>2</b>	<b>7</b>	<b>0</b>	<b>0</b>	<b>7</b>

\*Three Category B findings closed due to changes in reporting of SDSS findings (now reported in Defence's audit findings)

\*\*One finding reclassified from Category C to Category B.

### *Moderate audit issues—Category B*

#### *Outstanding issues from prior years*

#### Financial management and reporting framework

**4.130** During 2007-08 the DMO implemented a financial management and reporting framework (the framework). The ANAO reported a significant (Category A) audit finding relating to the design of the framework and the operation of internal controls. In 2008–09 this finding was reassessed to a moderate (Category B) finding due to improvements in some elements of the framework and DMO implementing additional control practices and procedures to support the accurate and complete reporting of financial statement balances.

**4.131** The DMO continues to implement improvements to the framework. However, weaknesses remain in relation to its alignment with business and financial operations, the effectiveness of specific control practices and testing of these practices. DMO has engaged a consultant and is utilising internal audit to assist with the remediation of these weaknesses. The ANAO will continue to review DMO's progress in addressing these matters during the 2009–10 final audit.

#### Commitments

**4.132** The DMO is required to accurately determine and appropriately manage its current and future commitments. In 2008–09, the ANAO encountered numerous issues relating to the completeness, valuation and accuracy of DMO's Commitments Schedule.

**4.133** As a result of these issues, significant remediation work has been undertaken by the DMO to produce a complete and accurate Commitments Schedule. The ANAO will review the Schedule during the 2009–10 final audit.

#### Controls within the Purchase to Pay Cycle

**4.134** During the 2008–09 audit, the ANAO continued to identify a number of issues regarding the approval and exercise of delegation, the retention of supporting documentation of the purchase of goods and services, supporting documentation not reconciling to purchase orders and incomplete documentation for evidencing of goods and services received prior to payment.

**4.135** These issues increase the risk that the controls around the purchase to pay cycle were not working as intended, and that payments may not be properly made. The ANAO will finalise its review of these issues during the 2009–10 final audit.

#### Enterprise Wide Business Continuity Plan

**4.136** One of the key elements of managing continuity risk involves the development and testing of Business Continuity Plans (BCPs). A BCP supports business response strategies, and should be developed and documented to allow the DMO to respond to a wide variety of potential business disruptions. Regular structured testing and maintenance of the BCP enables it to remain relevant and can also assist in maintaining the integrity of the systems supporting the production of financial statements in the event of a business disruption.

**4.137** The 2008–09 audit identified that, while the DMO had an enterprise wide BCP, it was last updated in 2005 and the BCP had not been subject to testing. During our 2009–10 interim audit the ANAO received a draft DMO Business Continuity Plan (including business impact analysis). The DMO BCP, covering the Russell and Brindabella Park precincts, has since been approved. An independent ‘desktop’ test of the plan was successfully conducted on 4 June 2010. The Defence policy requires BCPs to be developed by Groups by location and relies on enabling Groups to ensure continuity of essential Defence-wide services such as IT support. The DMO is compliant with this Defence policy. Additional refinement by DMO forms part of the broader program of activity over Business Continuity Planning in both Defence and DMO, and involves the preparation of Business Impact Analysis by Defence



groups, and the preparation of Business Continuity Plans, scheduled for completion by July 2011.

#### IT Bureau Service Arrangements between Defence and the DMO

**4.138** The Defence IT systems utilised by the DMO via bureau service arrangements are an integral part of DMO's internal control framework and have a significant impact on the DMO's financial reporting process. A number of breakdowns within the Defence control environment for these systems have been previously reported to Defence, with specific control weaknesses identified in relation to the Shared Services Agreement, Defence Computing Bureau, IT Governance, the financial management framework and financial and human resources management systems.

**4.139** The DMO requires assurance over the integrity of transactions processed by these systems, as these transactions are reported in the DMO's financial statements. However, existing arrangements between Defence and the DMO do not provide mechanisms that allow the DMO to obtain the necessary assurance from Defence over the effectiveness of controls in the following systems and processes:

- the financial management information system;
- the human resource management system; and
- system security and change management processes.

**4.140** A Shared Services Agreement between the DMO and Defence was formalised in 2006. The ANAO reported that the Shared Services Agreement should be updated to reflect all changes since the agreement was made. The ANAO also reported that the updated agreement should reflect arrangements that allow the DMO to obtain the necessary assurance, from Defence, over the effectiveness and adequacy of controls in the areas referred to above. The new Agreement should also outline the arrangements by which the DMO provides assurance to Defence over the effectiveness and adequacy of controls for the inventory systems managed by the DMO.

#### Bureau service arrangements for Supply Chain Systems and Processes

**4.141** As part of the 2008–09 audit, the ANAO assessed the effectiveness of controls related to SDSS, the inventory management information system, and the DMO's overall management of the supply chain process. A number of issues were identified relating to the management assurance and testing framework, the SDSS IT controls framework and core support processes, that

increased the risk that the DMO's financial transactions for cost of goods sold (GSI and RI) were incomplete or inaccurate.

**4.142** Without appropriate management oversight and assurance of key financial systems within the Supply Chain Systems control environment, the DMO cannot be assured that an appropriate level of rigour is applied to control activities related to supply chain systems and processes related to purchasing. As a result, the ANAO continues to place limited reliance on these systems that are used to produce GSI and RI financial statement balances. A mainly substantive audit approach is undertaken that involves significant additional audit time and resources.

**4.143** DMO has advised that it continues to work with Defence to achieve an efficient and well-defined controls assurance framework over supply chain systems and processes, including SDSS.

#### Cash Management

**4.144** During the 2008–09 final audit, the ANAO identified that \$10.4 million USD transferred to a newly established official DMO bank account was incorrectly recorded and classified as an expense. The amount transferred should have been accounted for as a cash balance. The DMO corrected the classification error, but failed to re-state the balance using the correct closing foreign exchange rate as required by AASB 121 *The effects of changes in Foreign Exchange Rates*.

**4.145** As at 30 June 2009, there were similar official DMO bank accounts in existence. The ANAO considered that a review of all official DMO banks accounts was necessary to ensure all cash balances were being correctly reported. The ANAO also considered that policies, procedures and guidance should be developed to assist with the correct classification and accounting treatment of all funds transferred and the balance of all bank accounts set up under agreements entered into by the DMO.

**4.146** The DMO, in consultation with the Department of Finance and Deregulation, has prepared a draft position paper on this issue. The ANAO will review the DMO's proposed accounting treatment as part of the 2009–10 final audit.

## Conclusion

**4.147** The range of issues identified in 2009–10 and earlier years reduce the level of reliance the DMO and the ANAO can place on financial information generated from the general ledger and related IT systems. Accordingly, the ANAO performs a greater level of substantive testing of balances and transactions in order to obtain the required level of audit assurance.

**4.148** The remediation of the identified control issues will provide a greater level of confidence over, and increased efficiency of, the DMO's financial management and reporting of business performance.

## Department of Veterans' Affairs

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

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

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

**4.151** The key characteristics of DVA's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- a complex legislative environment surrounding the provision of benefits to veterans and defence personnel;

- complex IT systems, including a number of heritage systems, to process a significant number of high volume, low value transactions on a regular basis;
- the diverse range of entitlements administered by DVA and the reliance placed upon voluntary disclosure of information by recipients; and
- contractual arrangements with service providers, institutions, and state governments.

## Financial overview

4.152 DVA's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	303	31		
Appropriation revenue	316	327		
Administered income			9	10
Administered expenses			11 654	11 615
Total assets	188	170	1 667	1 486
Total liabilities	114	114	2 876	2 718

DVA's estimated average staffing level for 2009–10 is 1 962 (2008–09 : 2 050).

## Governance arrangements

4.153 DVA has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DVA's business objectives. These arrangements support the achievement of DVA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.154 The key elements of DVA's governance arrangements include:

- the 2009–10 Corporate Plan that sets out DVA's focus and direction as well as the risks and challenges facing DVA. In order to assess progress against the priorities identified in the Corporate Plan, DVA has a monthly report card process, which includes financial, operational and strategic analysis;

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

## Areas of audit focus

**4.155** In light of the ANAO's understanding of DVA's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact DVA's financial statements. An area highlighted for specific audit coverage in 2009–10 is the allocation of residential aged care payments between DVA and other agencies in the light of previous audit findings that identified the need for improved controls over these payments.

**4.156** ANAO will continue to provide audit coverage on the following areas which have previously been identified as having a significant impact on the financial statements:

- the calculation of the Military Compensation provision and associated future claims;
- recognition of residential aged care payments;
- the significant amount of high volume, low value pension payments being processed on a regular basis by DVA using complex and ageing information systems;
- the recognition, measurement, impairment and reporting of intangible assets; and
- the quality assurance framework.

**4.157** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.158** The ANAO has assessed the risk of material misstatement in the 2009–10 DVA financial statements as moderate.

## **Audit results**

**4.159** Audit coverage to date of the systems, including information systems, and controls relating to the pension payments, has identified the moderate audit issues detailed below. Weaknesses identified in respect of residential aged care payments and quality assurance framework have resulted in the need to increase audit coverage and further work in these areas will be undertaken during the 2009–10 final audit. The other areas of audit focus will also be examined as part of the final audit.

**4.160** The following table provides a summary of the status of prior year issues as well as the audit issues raised by the ANAO in the 2009–10 interim audit.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	1	1	0	3	4
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>3</b>	<b>4</b>

### *Moderate audit issues – Category B*

#### *Prior year audit issue*

##### Residential aged care payments

**4.161** In the final phase of the 2008–09 audit, the ANAO reported that there were limited controls in place to provide assurance that payments are made from DVA appropriations to residential care facilities for DVA veterans. In addition, there was no Memorandum of Understanding with related agencies which outlines the terms and conditions of processing and reporting of residential aged care payments.

**4.162** Our 2009–10 audit identified that the business rules over the source data used to calculate residential aged care payments were not applied effectively and DVA had limited monitoring and reconciliation controls to ensure that business rules are operating correctly.

**4.163** DVA has held discussions with both the Department of Health and Ageing and Medicare Australia to establish a Business Partnership Agreement and regular reporting of residential aged care payments. ANAO will review this issue as part of its 2009–10 final audit coverage.

#### *New audit issues*

##### Quality assurance framework

**4.164** DVA has established a quality assurance framework over benefit payments to veterans to obtain assurance that payments are accurate, complete and made in a timely manner. The 2008–09 audit identified that the quality assurance framework required strengthening by addressing business risks, completing reviews and reporting results to management in a timely manner. In response, DVA has developed process documentation and an action plan to address some of the issues.

**4.165** Recent internal audit reviews also identified a significant number of issues relating to the quality assurance process.

**4.166** DVA advised that it recognises the importance of the quality assurance framework and is currently addressing the issues raised by the ANAO and Internal Audit.

#### Electronic purchasing process

**4.167** DVA implemented an electronic purchasing process in 2009–10 to streamline the purchasing and payment of goods and services. The 2009–10 audit identified that the delegations in the electronic purchasing process did not fully reflect the delegations issued by the Secretary and were not accurately applied to each invoice.

**4.168** DVA advised that it was working to resolve this matter.

#### Reconciliation procedures

**4.169** A review of the reconciliations to support payroll and asset balances in the general ledger identified that reconciliations were not always completed and reviewed in a timely manner, with large variances remaining unresolved for a significant period of time. These weaknesses have led to the Official Departmental Payroll Settlement Account being in overdraft for an extended period.

**4.170** DVA advised that it was investigating the identified variances and taking action to ensure that future reconciliations are carried out appropriately.

### **Conclusion**

**4.171** The ANAO has found that, subject to the moderate audit issues referred to above, DVA's key internal controls were operating satisfactorily to provide reasonable assurance that DVA will be able to prepare financial statements free of material misstatement.



# Education, Employment, and Workplace Relations Portfolio

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## Department of Education, Employment and Workplace Relations

**4.172** The Department of Education, Employment and Workplace Relations (DEEWR) provides advice and administers programs to achieve the government's objectives for education, employment and workplace relations.

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

- program management and delivery aimed at providing universal access to high quality education, world-class teaching and learning in schools and effective training and learning opportunities through education providers;
- investment in employment and training services for the unemployed and disadvantaged to support the government's workforce participation and social reform agendas; and
- the delivery of personal benefits, including child care benefit, child care rebate, youth allowance, parenting allowance and Austudy/Abstudy payments that aim to remove barriers to employment and education opportunities.

**4.174** The key characteristics of DEEWR's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the significance and diversity of administered activities;
- reliance on critical data from third parties to support payments made under a variety of programs including employment services, child care grants, and university superannuation liabilities;
- administration of the largest non-taxation receivable in the Commonwealth (Higher Education Loan Programme);
- the integration of the IT environments of the former departments of Education, Science and Training, and Workplace Relations; and
- a complex financial statement process that involves using data from a number of business systems, including those of other agencies.

## Financial overview

4.175 DEEWR's key financial figures are:

Key financial balances	Departmental Estimated	Departmental Actual	Administered Estimated	Administered Actual
	(\$m) 2009–10	(\$m) 2008–09	(\$m) 2009–10	(\$m) 2008–09
Net cost of services	850*	1 886		
Appropriation revenue	850*	1 884		
Administered income			1 744	1 232
Administered expenses			42 645	39 377
Total assets	502	457	16 554	15 668
Total liabilities	249	229	5 600	5 422

\*The net cost of services and appropriation revenue are budgeted to significantly decrease in 2009–10 due to amounts previously paid under a purchaser-provider arrangement for the delivery of personal benefit payments now being directly appropriated to Centrelink

DEEWR's estimated average staffing level for 2009–10 is 5 500 (2008–09 : 5 489).

## Governance arrangements

4.176 DEEWR has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DEEWR's business objectives. These arrangements support the achievement of DEEWR's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.177 The key elements of DEEWR's arrangements 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;
- a governance committee framework, including an audit committee and a program implementation steering committee;
- an internal audit function providing an internal audit strategy and plan utilising risk based audit coverage of DEEWR's activities;
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and the Secretary's annual Certificate of Compliance;

- a framework for incorporating risk management and the consideration of fraud risk into DEEWR's broader management and business planning processes;
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports; and
- a structured system of internal control.

### **Areas of audit focus**

**4.178** In the light of the ANAO's understanding of DEEWR's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact DEEWR's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- review and assessment of the compliance activities and assurance processes underpinning personal benefits, child care and employment related payments;
- a continued focus on assessing the robustness of actuarial estimates in DEEWR's financial statements. We will undertake a detailed review of the actuarial work performed to estimate the Higher Education Loan Programme (HELP) receivable;
- the ongoing review of grants financial management and reporting processes;
- an assessment of the completeness and accuracy of the accrual elements of administered programs required to be reported at year end; and
- an IT review of significant changes made to the IT environment.

**4.179** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.180** The ANAO has assessed the risk of material misstatement in the 2009–10 DEEWR financial statements as high.

## Audit results

**4.181** The ANAO has commenced work in the areas of compliance activities and assurance processes relating to personal benefits, child care and employment related payments, as well as grants management processes. No significant or moderate issues have been identified.

**4.182** The ANAO's review of significant IT changes identified an issue relating to FMIS user access that is detailed below.

**4.183** The remaining areas of audit focus relate to work that will be undertaken as part of the final audit. Any issues identified as part of this work will be reported in the ANAO's year end report to the Parliament.

**4.184** The following table provides a summary of the status of prior year issues as well as the audit issues raised by the ANAO in the 2009–10 interim audit.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>

#### *Moderate audit issue – Category B*

##### FMIS User Access

**4.185** A review over access controls in the newly implemented FMIS identified that a number of generic user accounts (these are accounts that do not enable individual users to be identified) were not being monitored. These accounts provided a level of access that allowed users to edit and change data within the FMIS, and to by-pass controls designed to ensure the appropriate segregation of duties. This situation put at risk the integrity of financial information if such access was used inappropriately.

**4.186** DEEWR has advised the ANAO that all privileged user access has been removed and a review of access by privileged users did not detect any inappropriate activity. Procedures for regular monitoring of access have also

been implemented for any temporary privileged user access granted in the future. The ANAO will review the matter during the 2009–10 final audit.

## **Conclusion**

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

# Environment, Water, Heritage and the Arts Portfolio

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## Department of the Environment, Water, Heritage and the Arts

**4.188** The Department of the Environment, Water, Heritage and the Arts (DEWHA) has a central role in environment, community and household energy efficiency, water, heritage, and cultural matters with a national focus. DEWHA is also responsible for supporting Australia's Antarctic activities.

**4.189** DEWHA's business operations include:

- conserving and protecting Australia's terrestrial and marine biodiversity and ecosystems, including support for research and natural resource management, regulating matters of national environmental significance and managing Commonwealth protected areas;
- improving the capacity of communities and industry to protect the environment through a range of activities including regulating hazardous substances, wastes and other pollutants, and reducing carbon emissions through supporting renewable energy sources;
- providing support for scientific, environmentally and economic interest in Antarctica and Australia's commitment to the entire Antarctic region;
- continuing the management of water resources through the delivery of the Government's Water for the Future initiative, in particular the commitment in relation to the Murray Darling Basin and the purchasing of water entitlements to improve the health of rivers, waterways and freshwater ecosystems; and
- supporting and participating in the access to Australia's culture, arts and heritage.

**4.190** In 2009–10 DEWHA continued to administer a \$4 billion Energy Efficient Homes package to help Australian households and communities to better manage their impact on the environment. Additional funding was provided to meet commitments under the Solar Homes and Communities Plan, and funding of some \$985.8 million was also brought forward for the

Home Insulation Program (HIP). DEWHA also continues to focus its efforts on delivering the Government's \$12.9 billion Water for the Future initiative.

**4.191** In February 2010, DEWHA's operations were affected by government decisions relating to a number of environmental programs. This included the cessation of the HIP, and the discontinuation of the Solar Hot Water Rebate that will become a component of the Renewable Energy Bonus Scheme later in the year. The Government also plans to redesign and extend the Green Loans Program. Responsibility for these programs, together with the energy efficiency and renewable energy function, were transferred from DEWHA to the Department of Climate Change and Energy Efficiency on 8 March 2010.

**4.192** The key characteristics of DEWHA's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the significant and diverse grant programs the department administers;
- the implementation of a new grant management information system, Clarity, that will be used to manage a number of grants programs, in particular the Solar Hot Water Rebate Scheme and Caring for our Country programs; and
- issues associated with the implementation of the Home Insulation Program.

## Financial overview

**4.193** DEWHA's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2009–10</b>	<b>Departmental Actual (\$m) 2008–09</b>	<b>Administered Estimated (\$m) 2009–10</b>	<b>Administered Actual (\$m) 2008–09</b>
Net cost of services	525	472		
Appropriation revenue	501	443		
Administered income			46	543
Administered expenses			3 827	1 922
Total assets	656	651	9 015	8 135
Total liabilities	390	354	128	128

DEWHA's estimated average staffing level for 2009–10 is 2 652 (2008–09 : 2 666).

## **Governance arrangements**

**4.194** DEWHA has designed and implemented governance arrangements, a financial reporting regime and an internal control system designed to provide reasonable assurance about the achievement of DEWHA's business objectives.

**4.195** The key elements of the DEWHA's arrangements include:

- a senior executive committee that meets weekly to evaluate DEWHA's strategic direction, financial planning and operational results;
- a governance committee framework, including 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 strategy and plan that considers key business and financial risks;
- a structured framework for incorporating risk management into the broader management and business processes including the development of a fraud control plan that is in line with Commonwealth Fraud Control Guidelines; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas on a monthly basis.

## **Areas of audit focus**

**4.196** In the light of the ANAO's understanding of DEWHA's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular audit focus areas that have the potential to significantly impact DEWHA's financial statements. Areas highlighted for audit coverage in 2009–10 are:

- ongoing review of grants financial management and reporting processes, in particular the Solar Homes and Communities Plan, Solar Hot Water Rebate, Home Insulation Program, National Solar Schools Plan and the Green Loans Program;
- implementation and integration of the grants management system 'Clarity' with the Financial Management Information System (FMIS);



- complexities of accounting and valuation issues, in particular for water entitlements, and the make good obligations for the Antarctic; and
- asset management, including the stocktake of Antarctic asset holdings.

4.197 As outlined in Chapter 3, the ANAO continues to review agencies’ IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

4.198 The ANAO has assessed the risk of material misstatement in the 2009–10 financial statements as moderate.

### Audit results

4.199 The ANAO has commenced work in the area of grants financial management and reporting. Work is yet to be completed of the Energy Efficiency Program, in particular the discontinued Home Insulation Program, due to the complexity of these programs and the number of external reviews being undertaken.

4.200 The ANAO’s review of the implementation and integration of the grant management system with the FMIS focussed on the mitigation of those risks that impacted on the 2009–10 financial statements. There were no significant or moderate audit issues raised from this review.

4.201 The remaining areas of audit focus relate to work that will be undertaken as part of the 2009–10 final audit. Any issues identified as part of this work will be reported in the ANAO’s year end report to the Parliament.

4.202 The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>

**4.203** The 2009–10 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 audit issue – Category B***

**User access to the FMIS**

**4.204** The ANAO conducted a security review of DEWHA’s FMIS and identified that privileged user access was not being monitored. Privileged users are able to edit and change data within the FMIS and to by-pass controls designed to ensure the appropriate segregation of duties. This exposed DEWHA to an increased risk of unauthorised changes to FMIS data and put at risk the reliability of financial information in DEWHA’s FMIS system. These risks can be mitigated by effective monitoring of the user access.

**Conclusion**

**4.205** The ANAO’s audit coverage of the Energy Efficiency Program, including expenditure incurred under the Home Insulation Program, will be completed as part of our 2009–10 final audit. This work will enable the ANAO to complete its assessment of the key controls that support the preparation of the department’s 2009–10 financial statements.

# Families, Housing, Community Services and Indigenous Affairs Portfolio

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

**4.206** 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.

**4.207** FaHCSIA has four key modes of business delivery:

- Payments to individuals—FaHCSIA makes direct payments to individuals through Centrelink and other agencies. Primary examples include the Age Pension, the Disability Support Pension and the Family Tax Benefit;
- Working with the states and territories—FaHCSIA works with the states and territories to achieve outcomes in a number of shared policy areas including housing, disability services, Indigenous reforms, concessions, and the welfare of children;
- Payments for community services—FaHCSIA funds community based organisations to deliver a range of local services including Family Relationship Services, Emergency Relief and Disability Employment Services; and
- Policy development, leadership, advice and coordination—FaHCSIA supports Ministers in their policy roles by providing advice on social policy, building the evidence base for action, and in whole of government policy coordination for Indigenous affairs and for women.

**4.208** The key characteristics of FaHCSIA's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- reliance on other government agencies to deliver personal benefit payments;

- significant judgement estimation involved in calculating material financial statement balances, such as the Family Tax Benefit provision;
- the need to comply with numerous grant payment conditions, and a decentralised grant management function; and
- the legislative and accounting standards compliance regime relating to its high value and complex transactions.

## Financial overview

4.209 FaHCSIA's key financial figures are:

Key financial figures	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	573*	1 662		
Appropriation revenue	573*	1 658		
Administered income			379	660
Administered expenses			67 531	75 737
Total assets	398	429	5 008	4 787
Total liabilities	137	212	7 471	7 846

\*The significant reduction in the estimated net cost of services and appropriation revenue is the result of a change in the funding arrangements for the services provided by Centrelink to FaHCSIA. Centrelink previously received the majority of its funding from the policy agencies that purchased their services on a fee for service basis. Commencing from 1 July 2009, this arrangement was replaced by direct appropriation funding to Centrelink for the provision of services on behalf of policy agencies.

FaHCSIA's estimated average staffing level for 2009–10 is 2 743 (2008–09 : 2 639).

## Governance arrangements

4.210 FaHCSIA has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance on achievement of FaHCSIA's business objectives. These arrangements support the achievement of FaHCSIA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.211 The key elements of FaHCSIA's arrangements include:

- an Executive Management Group (EMG) that meets fortnightly. The EMG takes an active interest in the financial operations of FaHCSIA and receives monthly detailed reports from the Chief 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. A financial statements sub-committee, comprising an independent RAAC member and a FaHCSIA Branch Manager, manages and reviews the department's financial reporting requirements;
- an Internal Audit and Fraud Branch that undertakes a risk based audit coverage of FaHCSIA's activities;
- a fraud control plan covering the period 2009–11; 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.

### **Areas of audit focus**

**4.212** In the light of the ANAO's understanding of FaHCSIA's environment and governance arrangements, which includes a financial reporting regime and a system of internal control, the ANAO has identified the following areas for specific audit coverage in 2009–10:

- personal benefits payments and related debts that are processed by Centrelink;
- FaHCSIA's management controls over the personal benefit payments as it has ultimate responsibility for administration, funding and reporting of the benefit payments; and
- the valuations performed by valuers of personal benefit related asset and liability balances.

**4.213** We will continue audit coverage on the following areas which have previously been identified as having a significant impact on the financial statements:

- the financial management of grants, including adequacy of supporting documentation on action taken and progress to clear a backlog of grant acquittals;

- appropriations reporting and disclosure, specifically resulting from an increase in the number of outcomes from four to seven;
- identification and valuation of investments in fixed deposits and government securities; and
- accounting processes and controls surrounding asset valuation and recording of assets and related balances due to weaknesses identified in the prior year relating to the integrity of the fixed assets register and depreciation calculations.

**4.214** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.215** The ANAO has assessed the risk of material misstatement in the preparation of the 2009–10 financial statements as moderate.

## **Audit results**

**4.216** The audit coverage to date has focused on a review of Centrelink's assurance framework which is designed to provide assurance to FaHCSIA and other policy agencies on personal benefits payments made by Centrelink, and related debt management processes undertaken by Centrelink on behalf of policy agencies. This framework includes detailed compliance and quality assurance processes that Centrelink has in place over personal benefits payments. Our audit also involved a review of the management controls established by FaHCSIA to monitor these payments. No significant or moderate issues have been identified to date. Our work on grants and asset management will be completed during the 2009–10 final audit, along with the remaining areas of audit focus.

**4.217** The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	0	0	2	2	0	0	2
<b>Total</b>	<b>0</b>	<b>0</b>	<b>2</b>	<b>2</b>	<b>0</b>	<b>0</b>	<b>2</b>

### *Prior year moderate audit issues – Category B*

#### Administration of grants

**4.218** In 2008–09, the ANAO reported a moderate control weakness relating to the administration of Indigenous grants in FaHCSIA’s Northern Territory offices. Our audit indicated that there was insufficient supporting documentation for grant payments and variations to funding agreements and a lack of compliance with the terms and conditions of the funding agreement. There was also a need to improve grant acquittal processes to ensure they were effective and timely. FaHCSIA is in the process of implementing procedures to address these issues.

#### Integrity of the assets register

**4.219** In 2008–09 the ANAO also reported a moderate control weakness relating to the integrity of data within the fixed asset register. FaHCSIA has revalued its assets using an independent valuer and is currently in the process of updating the assets register based on the valuer’s report.

**4.220** The ANAO will review the remedial action taken on these matters as part of the 2009–10 final audit.

## Conclusion

The ANAO has found that, subject to the two moderate issues referred to above, FaHCSIA’s key internal controls were operating satisfactorily to provide reasonable assurance that FaHCSIA will be able to prepare financial statements free of material misstatement.

# Finance and Deregulation Portfolio

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## Department of Finance and Deregulation

**4.221** The Department of Finance and Deregulation (Finance) assists the Government across a wide range of policy areas particularly financial management, deregulation reform and the operations of government.

**4.222** 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 superannuation schemes; administers the Nation Building Fund 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.

**4.223** The key characteristics of Finance's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- a number of financial statement balances that require significant judgement or the use of specialists to estimate; and
- a complex financial statement process that involves using data from a number of business systems.



## Financial overview

4.224 Finance's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated	Actual	Estimated	Actual
	(\$m) 2009–10	(\$m) 2008–09	(\$m) 2009–10	(\$m) 2008–09
Net cost of services	162*	285		
Appropriation revenue	229	246		
Administered income			2 451	1 773
Administered expense			8 353	6 990
Total assets	2 050	1 883	21 942	23 617
Total liabilities	437	393	80 976	82 294

\*The large movement between 2008–09 and 2009–10 relates to the 2008–09 amount including a \$90m downward revaluation of investment land and buildings and \$12m in losses from the sale of assets, while the estimate for 2009–10 includes an estimated \$16m gain from the revaluation of land and buildings and an estimated \$2m gain from the sale of assets.

Finance's estimated average staffing level for 2009–10 is 1 429 (2008–09 : 1 314).

## Governance arrangements

4.225 Finance has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Finance's business objectives. These arrangements support the achievement of Finance's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.226 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 oversees 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 providing an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives;

- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and Finance's annual Certificate of Compliance;
- a risk management process that 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;
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports; and
- a fraud risk assessment process and fraud control plan.

## **Areas of audit focus**

**4.227** In the light of the ANAO's understanding of Finance's environment and governance arrangements, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact Finance's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- 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 financial management of the Australian Government's self-managed general insurance fund (Comcover);
- the validity and accuracy of entitlements paid to Parliamentarians and their staff; and
- oversight of the Nation Building Funds.

**4.228** We will continue to provide audit coverage of the following areas which have previously been identified as significant to the financial statements:

- Finance's control environment and the establishment of adequate controls to enable compliance with aspects of relevant financial management legislation;
- management of various cross agency agreements and outsourced functions including property management and the administration of superannuation, insurance and the Nation Building Funds; and
- Finance's internal governance activities including fraud control, compliance with legislation (including the certificate of compliance) and internal audit activities.

**4.229** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.230** The ANAO has assessed the risk of material misstatement in the 2009–10 financial statements as moderate.

## **Audit results**

**4.231** The ANAO's interim audit work has mainly involved a review of the controls in place surrounding: asset management procedures for the Australian Government's domestic portfolio; the financial management of the Australian Government's self managed general insurance fund (Comcover); the validity and accuracy of entitlements paid to Parliamentarians and their staff; and controls over payments to suppliers and employees. The ANAO also undertook a review of the controls relating to the Nation Building Funds. The audit has identified one moderate audit issue in relation to the HRMIS that is explained below.

**4.232** Audit work on the Australian Government's public sector unfunded superannuation liability will be undertaken as part of the 2009–10 final audit. Further audit work will also be undertaken on the other areas of audit focus during the final audit.

**4.233** The following table provides a summary of the status of prior year issues as well as the audit issues raised by the ANAO in the 2009–10 interim audit.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	2	(2)	1	1	(1)	1	1
<b>Total</b>	<b>2</b>	<b>(2)</b>	<b>1</b>	<b>1</b>	<b>(1)</b>	<b>1</b>	<b>1</b>

### *Moderate audit issues—Category B*

#### HRMIS Security Access

**4.234** During the course of the 2009–10 audit, the ANAO identified a security weakness in Finance’s Human Resource Management Information System (HRMIS). The issue relates to the username and password for a HRMIS superuser being available in free text on a network drive that was able to be accessed by a significant number of Finance staff. This superuser had full administration privileges, including the ability to access and edit standing data, as well as create new users and edit system logs. The superuser’s password had not been changed for many years, including when the HRMIS transitioned from being managed by a contracted entity to an in-house HR service. In addition, our audit identified that the system configuration allowed unlimited login attempts for this username and the audit log for the user was not reviewed. The ANAO noted a number of controls that went some way to mitigating this control weakness. Finance has advised they have taken action to address the weaknesses identified by the ANAO.

#### *Prior year audit issue*

#### Former Prime Ministers’ entitlements

**4.235** In 2008–09, the ANAO raised an issue in relation to the recognition of former Prime Ministers’ entitlements in Finance’s financial statements. The ANAO’s position was that a provision should be included to account for these entitlements. Finance has now advised that it will include this provision in its 2009–10 financial statements.

## Conclusion

**4.236** 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 prepare financial statements free of material misstatement.

## The Board of Guardians and the Future Fund Management Agency

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

**4.238** The FFMA's business operations include:

- continued development and implementation of an investment strategy for the Future Fund and the three Nation Building Funds, agreed by the Board and consistent with the Investment Mandate from Government;
- investing the assets of the Future Fund and three Nation Building Funds – the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund in line with the relevant investment strategies; and
- maximisation of returns earned on contributions to the Future Fund over the long term, in line with the Investment Mandate.

**4.239** The key characteristics of the Board's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the procedures and policies associated with the valuation of different investment instruments, particularly those which do not frequently trade in active markets;
- the use of external service providers to support the investment management function;
- the developing Compliance Monitoring and Reporting System; and
- the organisational structure including five subsidiaries used as special purpose investment vehicles and any associated tax implications.

## Financial overview

4.240 The Future Fund's key financial figures\* are:

Key financial balances	Budget Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Total income	8 008	(3 189)
Total expenses	184	129
Operating result	7 824	(3 319)
Total assets	68 833	62 747
Total liabilities	44	1 796

\*The Future Fund presents its financial statements in a format consistent with that used in the funds management industry.

\*The funding of the FFMA is drawn from the investment special account. For 2009–10 this funding is estimated to be \$26.9 million.

The FFMA's estimated average staffing level for 2009–10 is 63 (2008–09 : 48).

## Governance arrangements

4.241 The Board, supported by the FFMA, has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of the Board's business objectives. These arrangements support the achievement of the organisation's (Board and FFMA) financial reporting requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

4.242 The key elements of the organisation's arrangements include:

- a strategic asset allocation that provides an overview of the Future Fund's investment plan for the future;
- the Future Fund Board of Guardians meets at least 10 times per year;
- a governance committee framework, including a Board audit committee and a FFMA risk committee;
- an internal audit function providing an internal audit strategy and plan that addresses key business and financial risks;
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements;

- the use of a Risk & Control Matrix to support the FFMA in monitoring the key risks of the organisation;
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas including the preparation of monthly financial reports; and
- significant operational controls that reside with the outsourced custodian. These controls are subject to an independent bi-annual internal controls audit which tests that the controls are appropriately designed and are operating effectively. A substantive independent audit is also undertaken at 30 June each year to confirm the existence and valuation of investment assets.

### **Areas of audit focus**

**4.243** Areas highlighted for specific audit coverage in 2009–10 are:

- valuation of investments – the valuation of illiquid investments is complex and has been further impacted by changes in the economic environment. The valuation of investments from the perspectives of governance, financial accuracy, regulatory oversight and reputational management will also continue to be a focus area;
- review of the continually evolving Comprehensive Compliance Monitoring and Reporting Systems which strengthens the internal assurance process;
- review of the impact of changes in accounting standards applicable for the period ending 30 June 2010. A significant change for the Future Fund's financial statements will be the enhanced financial instrument disclosure requirements;
- review of the processes for monitoring external service providers, including the custodian;
- review of the tax implications relating to the five wholly owned subsidiaries; and
- the administration and investment of the three Nation Building Funds (Building Australia Fund, Education Investment Fund and Health and Hospitals Fund) with a focus on the new investment mandates for these funds.

**4.244** The ANAO has assessed the risk of material misstatement in the preparation of the 2009–10 financial statements as moderate.

### **Audit results**

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

**4.246** No significant or moderate audit issues were identified during the 2008–09 audit.

### **Conclusion**

**4.247** Audit results for the 2009–10 financial statement audit will be reported in the ANAO's end of year report to the Parliament.



# Foreign Affairs and Trade Portfolio

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## Department of Foreign Affairs and Trade

**4.248** The Department of Foreign Affairs and Trade's (DFAT) role is to advance the interests of Australia and Australians internationally. This involves working to strengthen Australia's security; enhancing Australia's prosperity; and helping Australian travellers and Australians overseas. DFAT provides foreign and trade policy advice to the Government and works with other government agencies to ensure that Australia's pursuit of its global, regional and bilateral interests is coordinated effectively.

**4.249** DFAT's business operations include:

- the advancement of Australia's international strategic, security and economic interests including through bilateral, regional and multilateral engagement on Australian government foreign and trade policy priorities;
- the protection and welfare of Australians abroad and access to secure international travel documentation through timely and responsive travel advice, and consular and passport services in Australia and overseas; and
- a secure Australian Government presence overseas through the provision of security services and information and communications technology infrastructure, and the management of the Commonwealth's overseas owned estate.

**4.250** The key characteristics of DFAT's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the geographical spread of operations;
- a complex and changing IT environment; and
- the reliance on external providers for key operations and financial information.

## Financial overview

4.251 DFAT's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	870	759		
Appropriation revenue	954*	872		
Administered income			394	335
Administered expenses			403	383
Total assets	2 891	2 809	479	403
Total liabilities	230	240	171	102

\*The estimated increase in appropriation revenue primarily relates to new measures in areas such as national security and border protection.

DFAT's estimated average staffing level for 2009–10 is 3 562 (2008–09 : 3 461).

## Governance arrangements

4.252 DFAT has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DFAT's business objectives. These arrangements support the achievement of DFAT's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.253 The key elements of DFAT's arrangements include:

- an executive committee that oversees the operational performance of divisions and posts, reviews departmental wide issues, monitors financial performance and considers reports prepared and referred by other internal committees;
- a governance committee framework including an audit and risk committee. This 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;
- a risk management framework and plan that identifies and manages risk at the strategic, business and project levels, and also at specific locations overseas;

- 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 Fraud Control Guidelines.

### **Areas of audit focus**

**4.254** In light of the ANAO's understanding of DFAT's environment and governance arrangements, that include a financial reporting regime and a system of internal control, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact DFAT's financial statements. Areas where we will focus our 2009–10 audit coverage are:

- the measurement and associated disclosures of administered balances relating to the National Interest Account (NIA) managed by the Export Finance and Insurance Corporation (EFIC);
- the basis for the valuation of the administered investment in EFIC;
- passport operations, including management of the service level agreement with the Australian Postal Corporation and progress against the finding from the 2008–09 audit relating to the management of passport revenue collection;
- overseas property management encompassing the revaluation process, leased and owned property and the relationship with the service provider, United Group Process Solutions; and
- the overseas operations including supplier expenditure and accounting for expenses for locally engaged staff.

**4.255** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.256** The ANAO has assessed the risk of material misstatement in the preparation of the 2009–10 financial statements as low.

### **Audit results**

**4.257** To date, our audit coverage of passport operations, valuation of the administered investment in EFIC and overseas operations, has not identified any significant or moderate audit issues. The overseas property revaluation

process and measurement and disclosure of NIA administered balances will be reviewed as part of the 2009–10 final audit.

**4.258** The following table provides a summary of the status of prior year issues as well as any 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

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

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	5	(1)	0	4	(4)*	0	0
<b>Total</b>	<b>5</b>	<b>(1)</b>	<b>0</b>	<b>4</b>	<b>(4)</b>	<b>0</b>	<b>0</b>

\*Three Category B findings have been reassessed to Category C findings.

*Prior year audit issues – Category B*

**4.259** Audit testing confirmed that DFAT has progressed action to address the following Category B issues which were outstanding at the end of the 2008–09 final audit:

- management of passport revenue collection – DFAT has documented policies and procedures for passport revenue collection and strengthened reconciliation processes through the timely follow up of identified variances;
- FMIS IT security, monitoring and reporting – a review of the IT security configuration controls confirmed that DFAT is making progress in this area and is implementing procedures to maintain evidence of reviews of user access. This issue has been downgraded to a Category C finding;
- HRMIS IT security, monitoring and reporting – DFAT has partially addressed this issue and as a result it has been downgraded to a Category C finding. DFAT is finalising procedures to implement role-based security and document evidence of access reviews; and
- enterprise-wide business continuity management – remediation has been significantly progressed, resulting in a downgrade to a

Category C finding, although at the time of the interim audit, the final enterprise-wide disaster recovery plan was in draft. The ANAO notes that DFAT continues to have in place business continuity plans for each Division and Overseas Mission, and disaster recovery plans for specific IT applications.

## **Conclusion**

**4.260** Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that DFAT can prepare financial statements free of material misstatement.

# Health and Ageing Portfolio

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## Department of Health and Ageing

**4.261** The role of the Department of Health and Ageing (DoHA) is to achieve better health and active ageing for all Australians. DoHA works to achieve this through its policy advice, management of programs, research and regulation activities, and working closely with other governments, government agencies, consumers and other stakeholders.

**4.262** DoHA's responsibilities relate to: population health; pharmaceutical services; medical services; aged care and population ageing; primary care; rural health; hearing services; Indigenous health; private health; health system capacity and quality; mental health; health workforce capacity; acute care; biosecurity and emergency response; and sport performance and participation.

**4.263** The department's consolidated financial statements include the Therapeutic Goods Administration, the National Industrial Chemicals Notification and Assessment Scheme and the Office of the Gene Technology Regulator.

**4.264** The key characteristics of DoHA's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- a complex environment that involves working with multiple government jurisdictions and agencies;
- the significant size of DoHA's administered payments, which include high volume, large value and complex personal benefits expenses and liabilities processed by Medicare Australia, and significant grants and subsidy payments to State and Territory governments, 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 extensive appropriations disclosure;
- actuarial estimation for the reporting for the Government's liabilities under the medical indemnity program; and
- consolidation of significant departmental business operations in DoHA's financial statements.

**4.265** The recent announcements by the government on the proposed structural reform changes in the health and hospital system do not impact on this year's audit, but could have a significant impact on the audit of DoHA's financial statements in future years. The ANAO will continue to monitor the implementation of the reforms and assess the implications for future financial statement audits.

## Financial overview

**4.266** DoHA's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	586	575		
Appropriation revenue	585	574		
Administered income			489	626
Administered expenses			41 904	49 731
Total assets	344	327	925	757
Total liabilities	241	230	2 699	2 608

DoHA's estimated average staffing level for 2009–10 is 4 586 (2008–09 : 4 363).

## Governance arrangements

**4.267** DoHA has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DoHA's business objectives. These arrangements support the achievement of DoHA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**4.268** The key elements of DoHA's arrangements include:

- an executive committee, chaired by the Secretary, that is responsible for the management and oversight of all major department policy, financial and operational decision making;
- a governance committee framework including an Audit Committee that includes two independent members, one of whom is the Chair, meets at least quarterly and provides advice and assistance on risk, control and compliance frameworks;

- an internal audit function that has primary responsibility for promoting and improving corporate governance within DoHA and operates under the direction of the 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, including fraud risks, identified in the ERMP are reported quarterly to the executive 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;
- a Certificate of Compliance regime that incorporates semi-annual control self assessments, that forms a key part of DoHA's corporate governance and compliance framework and 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 agencies regarding administered payments.

## **Areas of audit focus**

**4.269** In the light of the ANAO's understanding of DoHA's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identified the following areas of audit focus that have the potential to significantly impact DoHA's financial statements:

- administered grants and subsidies expenses, including aged care payments;
- high volume, high value and complex administered personal benefits expenses and liabilities;
- medical indemnity liabilities based on actuarial assumptions;
- appropriations reporting and disclosure. DoHA has 15 outcomes making the preparation and audit of the appropriation note complex; and



- accounting for fixed assets due to DoHA's move to new office accommodation in 2009–10.

**4.270** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.271** The ANAO has assessed the risk of material misstatement in the 2009–10 financial statements as moderate.

### **Audit results**

**4.272** The ANAO has completed its interim audit coverage to assess the effectiveness of internal controls in the areas which had been identified as significant to the financial statements, including administered grants, personal benefits and subsidies. The remaining areas of audit focus relate to work that will be undertaken as part of the 2009–10 final audit.

**4.273** The ANAO did not identify any significant or moderate audit issues during either the 2008–09 audit or the 2009–10 interim audit.

### **Conclusion**

**4.274** Based on audit work performed to date, controls were operating satisfactorily to provide reasonable assurance that DoHA can prepare financial statements free of material misstatement.

# Human Services Portfolio

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## Department of Human Services

**4.275** The Department of Human Services' (DHS) is responsible for the:

- development and coordination of policy to improve delivery of Australian Government social and health services;
- management by the Child Support Agency of Australia's child support arrangements including international agreements; and
- delivery of rehabilitation services by CRS Australia, primarily focusing on disability employment services provided on behalf of the Department of Education, Employment and Workplace Relations.

**4.276** In December 2009, the Minister for Human Services announced major reforms to Australian Government service delivery, including the amalgamation of Centrelink, DHS and Medicare Australia in to one Department of State, scheduled for 1 July 2011. Until legislative changes are made to amend governance arrangements, the Chief Executive Officers of Medicare Australia and Centrelink will continue to exercise their responsibilities under the FMA Act, including for the preparation and presentation for audit of a set of financial statements and maintaining an audit committee. Centrelink, DHS and Medicare Australia are working together on these service delivery reforms.

**4.277** The key characteristics of DHS's operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- child support arrangements, particularly in relation to child support assessments that are subject to complex legislative requirements;
- transactions relating to CRS Australia, which are processed on separate financial systems to that of the rest of DHS; and
- the nature of departmental expenditure that mainly consists of salaries, property, and information technology, which forms a significant proportion of DHS's financial statements.

## Financial overview

4.278 DHS's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	553*	491		
Appropriation revenue	558*	504		
Administered income			1 247	1 236
Administered expenses			1 229	1 340
Total assets	332	335	617	626
Total liabilities	177	178	626	606

\*The estimated increase in net cost of services and appropriation revenue for 2009–10 is largely attributed to additional funding for Child Support.

DHS's estimated average staffing level for 2009–10 is 5850 (2008–09 : 5332).

## Governance arrangements

4.279 DHS has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DHS's business objectives. These arrangements support the achievement of DHS's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.280 The key elements of DHS's arrangements include:

- an Executive Management Committee that provides strategic direction, and oversees the department's operations and performance;
- 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 focuses on matters relating to risk assessment and management, internal audit, external audit, fraud control and financial reporting; and a financial statement sub-committee that meets regularly, focussing on financial statement issues, risks and deliverables;

- an internal audit function that delivers a strategic risk based internal audit plan designed to assist line areas meet their key objectives via a combination of performance and compliance based audits;
- a fraud control plan that identifies, and assists in the management of, fraud risks; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

## **Areas of audit focus**

**4.281** In the light of the ANAO's understanding of DHS's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact DHS's financial statements. One area highlighted for specific audit coverage in 2009–10 is DHS's Disability Employment Services (DES) revenue in view of changed program delivery arrangements that took effect on 1 March 2010. The new arrangements will impact the calculation of the unearned revenue balance in DHS's financial statements. As a consequence, the ANAO will assess the estimation processes involved in calculating unearned revenue at year-end.

**4.282** The ANAO will continue to provide audit coverage of:

- Child Support transactions, specifically focusing on Child Support assessment controls and IT business system controls; and
- the valuations of asset and liabilities, primarily being land and buildings, infrastructure, plant and equipment and intangible assets, and employee entitlement provisions.

**4.283** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.284** The ANAO has assessed the risk of material misstatement in the 2009–10 DHS financial statements as low.

## Audit results

**4.285** The ANAO has substantially completed work in relation to the Child Support assessment and IT business system controls. No significant or moderate issues have been identified. The 2008–09 audit also did not identify any significant or moderate audit issues.

**4.286** Work relating to the valuation of assets and liabilities is predominantly undertaken as part of the 2009–10 final audit.

## Conclusion

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

## Centrelink

**4.288** Centrelink is a key service delivery organisation within the Human Services Portfolio, responsible for linking Australian Government welfare services. Centrelink's customers include retired people, families, sole parents, people looking for work, people with disabilities, illnesses or injuries, carers, widows, primary producers, students, young people, Indigenous people and people from diverse cultural and linguistic backgrounds. Centrelink previously operated under a purchaser/provider framework and obtained the majority of its funding on a fee for service basis through business partnership arrangements with the agencies that purchased Centrelink's services. Centrelink distributes approximately \$71 billion in personal benefit payments on behalf of government agencies under either bilateral or multilateral management arrangements. Under arrangements that took effect from 1 July 2009, Centrelink now receives direct appropriation funding for the cost of providing services to the policy agencies.

**4.289** Centrelink's business operations include:

- the design and implementation of service delivery systems;
- delivery of ongoing services and responding to emerging needs; and
- processes which make it easy for customers to do business with Centrelink, responding in a timely manner to customers' requests, and matching services and payments to customers' circumstances.

**4.290** The key characteristics of Centrelink’s business operations that shape the ANAO’s 2009–10 financial statement audit coverage include:

- voluntary disclosure of information by customers in relation to the assessment and payment of personal benefits;
- the need for the timely implementation of system changes in an environment of frequent legislative and policy changes in personal benefit programs;
- the complexity of the IT environment, particularly relating to developing and managing internal systems for benefit payments;
- managing agreements with agencies relating to service delivery responsibilities; and
- the impact of the service delivery reforms announced in December 2009 (referred to in paragraph 4.276 above).

## Financial overview

**4.291** Centrelink’s key financial figures are:

Key financial figures	Departmental	Departmental	Administered*	Administered*
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	2 780**	562		
Appropriation revenue	2 809**	610		
Administered income				
Administered expenses				
Total assets	1 095	1 058		
Total liabilities	761	750		

\*The administered revenue and expenses relating to personal benefits are disclosed in policy agencies’ financial statements, on whose behalf they are administered.

\*\*The significant increase in the estimated net cost of services and appropriation revenue is a result of changed funding arrangements under which Centrelink receives direct appropriation funding for the cost of providing services on behalf of policy agencies.

Centrelink’s estimated average staffing level for 2009–10 is 25 580 (2008–09 : 25 230).

## Governance arrangements

**4.292** Centrelink has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide

reasonable assurance about the achievement of Centrelink's business objectives. These arrangements support the achievement of Centrelink's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**4.293** The key elements of Centrelink's corporate governance that provides a positive contribution to the financial management regime of the agency include:

- a monthly meeting of the Centrelink executive, comprising of the Chief Executive and the senior managers who report directly to her;
- 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;
- 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.

## Areas of audit focus

**4.294** In the light of the ANAO's understanding of the Centrelink's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact Centrelink's financial statements and the financial statements of relevant policy agencies. Areas highlighted for specific audit coverage in 2009–10 relate to:

- the non-disclosure of changes in circumstances by customers that may affect the integrity of personal benefit payments disclosed in the financial statements of the relevant policy agencies. As a consequence, the review of compliance and quality assurance processes and random sample surveys, forms a significant part of the ANAO's audit examination of internal controls so that assurance can be provided in the context of the audit of policy agencies' financial statements;
- IT system changes in Centrelink in response to new payment initiatives. Our audit coverage includes an examination of IT change management and system development controls; and
- changes in policy and legislation that could result in delays in unplanned changes to relevant systems and reports by policy agencies. The ANAO focuses on gaining an understanding of the business processes that encourage regular communication with policy agencies, designed to ensure that accurate and timely information is received from Centrelink. A review of the assurance framework for policy agencies will also be undertaken by the ANAO.

**4.295** We will continue to provide audit coverage of the following areas which have previously been identified as having a significant impact on the financial statements:

- actuarial assessments and management decisions relating to the calculation of the employee benefit provision;
- the valuation of non-financial assets, particularly relating to assets under construction (AUC), such as leasehold improvements, internally generated software, and fixed asset revaluations; and
- the identification and calculation of the cost relating to internally developed software.



**4.296** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.297** The ANAO has assessed the risk of material misstatement in the 2009–10 financial statements as moderate.

## Audit results

**4.298** The audit coverage of personal benefit payments and related debt management and processes for updating the systems as a result of changes to policy and legislation has not identified any significant or moderate issues. The audit work on the other areas of audit focus will be completed in the final phase of the audit.

**4.299** The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

**4.300** There were no significant or moderate audit issues raised by the ANAO as a result of the 2009–10 interim audit.

## Conclusion

**4.301** The ANAO found that Centrelink's key internal controls were operating satisfactorily to provide reasonable assurance that Centrelink will be able to prepare financial statements free of material misstatement.

## Medicare Australia

**4.302** Medicare Australia is a service delivery agency that administers a broad range of health-related and other payment programs totalling over \$36 billion annually on behalf of the Australian Government. It plays an integral role in the Australian health sector by providing services to the Australian public, health professionals, private health organisations, State and Territory Governments and Australian Government agencies.

**4.303** Medicare Australia delivers services for a range of Government agencies, including the Departments of Health and Ageing, Veterans' Affairs, Families, Housing, Community Services and Indigenous Affairs, Defence, Environment, Water, Heritage and the Arts and Centrelink.

**4.304** Medicare Australia's business operations include:

- improving Australia's health through the delivery of Australian Government payments and information services;
- providing accurate and reliable information and payments;
- ensuring the integrity of the government programs it delivers;
- delivering agreed health and other Government initiatives, including service delivery reform;
- contributing to and implementing proposals to reduce Government red tape; and
- continuing to enhance convenience, ease of access and cost effectiveness of services by increasing the availability and use of electronic channels for claiming and service provision.

**4.305** The key characteristics of Medicare Australia's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the complexity of the IT environment to support significant business operations;
- the need to rely on external parties to provide information to support significant financial statement balances;
- a program of compliance activities relating to Medicare Australia's legislative and program requirements;
- the management of agreements and relationships for the key programs Medicare Australia delivers on behalf of the Australian Government;

- the impact of the service delivery reforms announced in December 2009 (referred to in paragraph 4.276 above); and
- Medicare Australia’s administration of aspects of the Home Insulation Program (HIP) on behalf of the Department of the Environment, Water, Heritage and the Arts (DEWHA), until the Program’s discontinuation.

## Financial overview

4.306 Medicare Australia’s key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	652	620		
Appropriation revenue	652	612		
Administered income			0	0
Administered expenses			4	5
Total assets	339	326	0	0
Total liabilities	198	193	0	0

Medicare Australia estimated average staffing level for 2009–10 is 5 251 (2008–09: 5 201).

## Governance arrangements

4.307 Medicare Australia has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Medicare Australia’s business objectives. These arrangements support the achievement of Medicare Australia’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.308 The key elements of Medicare Australia’s arrangements include:

- a Corporate Management Committee that meets monthly to provide strategic advice to the Chief Executive Officer;
- a Compliance Committee that addresses strategic issues focusing on protecting the integrity of the programs administered by Medicare Australia;
- 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 that complies with the Commonwealth Fraud Control Guidelines.

### **Areas of audit focus**

**4.309** In the light of the ANAO's understanding of Medicare Australia's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact Medicare Australia's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- the valuation of non-financial assets, including the use of an independent valuer to conduct the valuation; and
- Medicare Australia's service delivery responsibilities to DEWHA under HIP, including the registration of installers and the processing of claims and associated payments.

**4.310** We will continue to provide audit coverage of the following areas which have previously been identified as significant to the financial statements:

- calculation and disclosure of appropriations in the financial statements, including compliance with the funding agreement with the Department of Finance and Deregulation;
- programs and related payments delivered by Medicare Australia on behalf of other agencies, including the Department of Health and Ageing and the Department of Veterans' Affairs;
- accounting for Medicare Australia's lease transactions, including makegood provision and lease incentives;
- significant IT systems from which a number of financial statement balances are sourced; and

- Medicare Australia's national compliance program that focuses on the integrity of Government programs it delivers.

**4.311** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.312** The ANAO has assessed the risk of material misstatement in the preparation of the 2009–10 Medicare Australia financial statements as moderate.

## **Audit results**

**4.313** The ANAO has largely completed the work relating to Medicare Australia's system of internal controls including an assessment of the effectiveness of controls over significant IT systems, payments delivered on behalf of other agencies and the national compliance program covering program integrity. While no significant or moderate audit issues have been identified to date, the ANAO is reviewing certain aspects of Medicare Australia's responsibilities in relation to HIP in conjunction with the ANAO's financial statement audit of DEWHA. Any significant or moderate issues will be reflected in our end of year report to the Parliament on the results of financial statements audits. The remaining work to be completed on the other areas of audit focus will be substantially completed at or near the end of the financial year.

**4.314** In addition, the ANAO's performance audit of HIP will include coverage of Medicare Australia's service delivery responsibilities under HIP.

## **Conclusion**

**4.315** The ANAO found that key elements of internal control were operating effectively to provide reasonable assurance that Medicare Australia can prepare financial statements that are free of material misstatement. The effective operation of internal controls for the full financial year will be confirmed during the 2009–10 final audit.

# Immigration and Citizenship Portfolio

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## Department of Immigration and Citizenship

**4.316** The Department of Immigration and Citizenship (DIAC) is responsible for the delivery of a range of programs and services for the purpose of building Australia's future through the well-managed entry and settlement of people into Australia. DIAC's business operations include:

- administering the Australian Government's immigration laws and migration programs;
- development of migration policy;
- contributing to border management; and
- the delivery of services to support migrants and refugees to settle in the community and participate in Australian society.

**4.317** The key characteristics of DIAC's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- decentralised processing of visa revenue in Australia and at a number of overseas locations, supported by multiple IT systems, and involving other Australian Government agencies;
- fluctuating business activity, which impacts DIAC's appropriation revenue and, in turn, affects staffing and property requirements;
- extensive IT based business systems and associated processes; and
- financial reporting pressures and budgetary constraints that may impact DIAC's financial control framework.

## Financial overview

4.318 DIAC's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	1 232	1 256		
Appropriation revenue	1 232	1 209		
Administered income			1 020	848
Administered expenses			622	467
Total assets	1 203	1 168	56	25
Total liabilities	345	379	151	142

DIAC's estimated average staffing level for 2009–10 is 7 286 (2008–09 : 7 500).

## Governance arrangements

4.319 DIAC has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DIAC's business objectives. These arrangements support the achievement of DIAC's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.320 The key elements of DIAC's arrangements 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 focuses on matters relating to risk assessment and management, internal audit, external audit, fraud control and financial reporting;

- a financial statement sub-committee that meets regularly, focussing on financial statement issues, risks and deliverables; and
- an internal audit function that delivers a strategic risk based internal audit plan designed to assist line areas meet their key objectives via a combination of performance and compliance based audits.

**4.321** DIAC has a monthly financial reporting process that provides reports to the executive and divisions for review and analysis. The reports include a summary of the key financial issues to be considered by management, actual versus budgeted departmental revenue and expenditure by division, projected operating results, expenditure against capital budgets and a cash impact statement.

### **Areas of audit focus**

**4.322** In the light of the ANAO's understanding of DIAC's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact DIAC's financial statements. In 2009–10 we will provide audit coverage of the following areas which have previously been identified as significant to the financial statements:

- DIAC's control environment and the establishment of adequate controls to enable compliance with aspects of relevant financial management legislation, particularly in relation to Visa Application Charge revenue, and supplier and employee expenses;
- appropriation revenue recognised under DIAC's funding agreement with Finance;
- land and buildings, infrastructure, plant and equipment which are located in more than 100 sites worldwide; and
- the valuation of internally developed software, employee entitlements and surplus lease space provisions, all of which have been subject to accounting issues in prior years.

**4.323** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.



**4.324** The ANAO has assessed the risk of material misstatement in the 2009–10 DIAC financial statements as moderate.

## Audit results

**4.325** The ANAO has substantially completed work in relation to DIAC's control environment and controls relevant to Visa Application Charge revenue, and supplier and employee expenses. No new significant or moderate issues have been identified.

**4.326** The remaining areas of audit focus relate to work that is undertaken at or near year-end as part of the 2009–10 final audit.

**4.327** The following table provides a summary of the status of prior year issues.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	3	(1)	1	3	(1*)	0	2
<b>Total</b>	<b>3</b>	<b>(1)</b>	<b>1</b>	<b>3</b>	<b>(1)</b>	<b>0</b>	<b>2</b>

\*One Category B finding has been reassessed to a Category C finding.

### *Prior year moderate audit issues – Category B*

#### Asset management

**4.328** The 2008–09 final audit identified weaknesses in DIAC's asset management processes relating to delays in the completion of asset stock-takes; weaknesses in the method used to value offshore assets and related leasehold improvements' make-good provisions; deficiencies in the information held within the asset register; delays in the capitalisation of completed software projects; a lack of formal procedures to monitor the capitalisation of IT project expenditure; and non-compliance with accounting standard requirements to assess asset useful lives on an annual basis.

**4.329** During the 2009–10 interim audit, the ANAO confirmed DIAC had commenced work to address these matters. The ANAO will review the results of this work during the 2009–10 final audit.

#### Expenditure authorisation processes

**4.330** The 2008–09 interim audit identified weaknesses in DIAC’s purchase order processes that increased the risk that commitment information within DIAC’s FMIS for both financial statement and budget forecasting purposes was incomplete. During 2009–10 DIAC has made significant progress in implementing changes within the FMIS to strengthen purchase order processes. The ANAO will assess the effectiveness of these processes during the 2009–10 final audit.

#### *Moderate audit issues downgraded*

#### Offshore visa business system security and processing controls

**4.331** Previous audits of the offshore visa business system (IRIS) security and processing controls identified weaknesses in access management practices. DIAC has progressively implemented system changes that enhance the overall management of user access. The 2008–09 interim audit identified that outstanding issues remained over the reporting and monitoring of user access and the currency of the IRIS system security plan (SSP).

**4.332** The ANAO’s review of IRIS security during the 2009–10 interim audit confirmed that DIAC has implemented a new IRIS SSP. This included updating user security profiles within IRIS. An outstanding component of the audit finding relating to monitoring of user access has been re-assessed to a Category C issue.

## **Conclusion**

**4.333** The ANAO found that the majority of DIAC’s key internal controls reviewed were operating satisfactorily to provide reasonable assurance that the department can prepare financial statements free of material misstatement. Our interim audit has confirmed that DIAC continues to undertake 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

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## Department of Infrastructure, Transport, Regional Development and Local Government

**4.334** The Department of Infrastructure, Transport, Regional Development and Local Government (Infrastructure) provides a range of programs that support infrastructure, through investment in the coordination of transport, regional development and local government services and information to, and in partnership with, government, industry and the broader community.

**4.335** Infrastructure received significant levels of funding as part of the Government's economic fiscal stimulus package in 2008–09. In 2009–10 Infrastructure will continue to deliver the Australian Government's nation building initiatives, including the Regional and Local Community Infrastructure Program, the National Building Program and the National Building Plan for the Future.

**4.336** The key characteristics of Infrastructure's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the level of complexity of the large number of grant programs that are administered by the department; and
- the significant administered asset balances reported in the department's financial statements, particularly the Australian Government's investments in portfolio agencies.

## Financial overview

4.337 Infrastructure's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	211	246		
Appropriation revenue	209*	243		
Administered income			683	1 173
Administered expenses			4 025**	8 642
Total assets	129	173	3 288	2 930
Total liabilities	64	69	39	17

\*The estimated decrease in appropriation revenue was primarily due to the impact of the transfer of functions to the Australian Transport Safety Bureau, which was established as an independent statutory agency from 1 July 2009.

\*\*The reduction in budgeted administered expenses is mainly due to changes in arrangements for certain program payments that are now made by the Treasury to the States and Territories.

Infrastructure's estimated average staffing level for 2009–10 is 1 095 (2008–09 :1 086).

## Governance arrangements

4.338 Infrastructure has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Infrastructure's business objectives. These arrangements support the achievement of Infrastructure's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.339 The key elements of Infrastructure's arrangements include:

- an executive management group that meets weekly and addresses strategic issues, monitors Infrastructure's financial performance, and oversees the operational performance of divisions;
- a governance committee framework, including an audit committee that meets regularly and focuses attention on internal controls, management of risks, review of financial reports, control of public monies and regulatory compliance;

- an internal audit function that addresses key business and financial risks and aims to assist line areas meet their key objectives;
- a fraud control plan that is in line with Commonwealth Fraud Control Guidelines;
- mechanisms to facilitate internal and external financial integrity assurances, including the effectiveness of internal controls that impact on the financial statements and the Secretary's annual Certificate of Compliance;
- a framework for incorporating risk management into Infrastructure's broader management and business processes; and
- a financial reporting framework that involves monitoring the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

### **Areas of audit focus**

**4.340** In the light of the ANAO's understanding of Infrastructure's environment and governance arrangements that include a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact Infrastructure's financial statements. Areas highlighted for audit coverage in 2009–10 are:

- the financial management of grant programs administered by the department;
- Infrastructure's IT control environment, including an FMIS and a newly integrated paperless accounts payable system implemented in October 2009; and
- the valuation of Infrastructure's administered investments, which represent a significant asset balance in Infrastructure's financial statements.

**4.341** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.342** The ANAO has assessed the risk of material misstatement in the 2009–10 financial statements as moderate.

## **Audit results**

**4.343** The ANAO's audit coverage has focussed on Infrastructure's IT control environment and the interim integrated paperless accounts payable system. The ANAO has commenced work in the area of grant financial management and reporting. However, as the majority of grant expenditure is incurred in the last quarter of the financial year, further audit work will be undertaken during the 2009–10 final audit. A review of the valuation of Infrastructure's administered investments will also be undertaken as part of the final audit.

**4.344** No significant or moderate audit issues have been identified; no audit issues were identified during the 2008–09 audit.

## **Conclusion**

**4.345** Based on our audit coverage to date, the ANAO identified that Infrastructure's key internal controls were operating satisfactorily to provide reasonable assurance that Infrastructure will be able to prepare financial statements free of material misstatement.

# Innovation, Industry, Science and Research Portfolio

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## Department of Innovation, Industry, Science and Research

**4.346** The Department of Innovation, Industry, Science and Research (DIISR) aims to create an environment where new ideas are nurtured and innovation drives productivity, economic growth and social well being, by strengthening the links between science, research and industry. DIISR is responsible for developing policies and delivering programs in partnership with stakeholders, designed to provide lasting economic benefits ensuring Australia's competitive future.

**4.347** DIISR's business operations include:

- identifying enhanced opportunities for business innovation and growth through national leadership in converting knowledge and ideas into new processes, services, products and marketable devices; fostering business cooperation; delivering advice; assistance and business, measurement and online services; and
- the generation, utilisation and awareness of science and research knowledge through investment in research, research training and infrastructure, science communication, skill development and collaboration with industry, universities and research institutes domestically and internationally.

**4.348** The key characteristics of DIISR's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- a large range of administered programs, some of which are complex. The number and extent of programs is also continually changing as a result of new Government initiatives and the winding down of existing programs; and
- complex ownership structures for administered investments including the Innovation Investment Fund.

### Financial overview

**4.349** DIISR's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	303	281		
Appropriation revenue	303	282		
Administered income			425	41
Administered expenses			4 135	3 486
Total assets	250	239	2 655	2 631
Total liabilities	107	96	316	250

DIISR's estimated average staffing level for 2009–10 is 1 973 (2008–09 : 1 716).

## Governance arrangements

**4.350** DIISR has designed and implemented governance arrangements and a financial reporting framework to provide reasonable assurance about the achievement of DIISR's business objectives. These arrangements support the achievement of DIISR's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**4.351** The key elements of DIISR's governance arrangements include:

- a strategic plan that provides an overview of DIISR's future direction;
- regular meetings of the Secretary and senior managers to discuss key aspects of DIISR activities, including program management and financial performance;
- a structured framework for incorporating risk management into the broader management and business processes, including the development and maintenance of a fraud control plan;
- an audit committee that meets bi-monthly and focuses on the enhancement of the control framework and risk management arrangements to improve the objectivity and reliability of externally published financial and other information;
- an internal audit function that addresses key business and financial risks and aims to assist line areas meet their key objectives; and



- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

## Areas of audit focus

**4.352** In the light of ANAO's understanding of the DIISR's environment and governance arrangements, which includes the financial reporting framework, the ANAO's audit approach identified an area of audit focus that has the potential to significantly impact DIISR's financial statements relating to the accounting treatment of grant programs.

**4.353** In addition, we will continue to provide audit coverage of the following areas:

- lease accounting;
- DIISR's compliance with the revised Commonwealth grant guidelines;
- the project management of the implementation and integration of key financial systems;
- DIISR's processes to monitor payments made by other government agencies, including Centrelink and DEEWR, on behalf of DIISR; and
- the implementation of the Innovation Investment Follow on Fund (IIF) that is used for making additional investments in existing venture capital companies.

**4.354** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.355** The ANAO has assessed the risk of material misstatement in 2009–10 as moderate.

## Audit results

**4.356** The ANAO has commenced its review of the accounting for grant expenditure. No significant or moderate issues have been noted to date. Audit coverage of this area will be completed during the 2009–10 final audit. The remaining areas of audit focus relate to work that will also be undertaken as part of the final audit.

4.357 The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>

**Moderate audit issue – Category B**

Security and access over electronic payment data

4.358 The ANAO identified weaknesses in controls over the electronic transmittal of payment data to third parties who make payments on behalf of the DIISR. The transmittal process did not include sufficient security and access controls over the transfer of data. As a result there was a risk that the data transferred could be manipulated leading to the misuse of funds.

4.359 DIISR has developed revised procedures and commenced implementation of the controls to address this issue.

**Conclusion**

4.360 The ANAO has found that, subject to the issue referred to above, DIISR’s key internal controls were operating satisfactorily to provide reasonable assurance that DIISR will be able to prepare financial statements free of material misstatement.

# Prime Minister and Cabinet Portfolio

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## Department of the Prime Minister and Cabinet

**4.361** The principal function of the Department of the Prime Minister and Cabinet (PM&C) is to provide high-quality advice and support to the Prime Minister, the Cabinet Secretary, the Parliamentary Secretary and the Cabinet, and to achieve a coordinated and innovative approach to the development and implementation of government policies.

**4.362** PM&C has a central role in driving policy development and innovation and ensuring delivery of high-priority initiatives across the APS in pursuit of the government's objectives.

**4.363** In addition to its work on policy advice, innovation, coordination and implementation, the role of PM&C includes:

- providing advice on government and parliamentary administrative and policy matters such as Cabinet processes, accountability and the management of the public service;
- advising on legislation programming, legal and constitutional matters;
- providing secretariat support for meetings of the Cabinet, its committees and the Federal Executive Council;
- coordination and arrangements for official ceremonial occasions;
- the operation's of the Prime Minister's official residences; and
- staffing and administrative services to former Governors-General.

**4.364** The key characteristics of PM&C's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the stability of PM&C's business and the relatively non-complex nature of PM&C's IT systems;
- the transfer of former Governors-General's entitlements to the Department of Finance and Deregulation;
- the first time recognition of former Governors-General Other Entitlements provision; and
- the overall effectiveness of PM&C's internal control.

## Financial overview

4.365 PM&C's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	117	103		
Appropriation revenue	115	103		
Administered income			-	0
Administered expenses			9	14
Total assets	62	71	43	43
Total liabilities	29	30	12	17

PM&C's estimated average staffing level for 2009–10 is 618 (2008–09 : 534).

## Governance arrangements

4.366 PM&C has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of PM&C's business objectives. These arrangements support the achievement of PM&C's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.367 The key elements of PM&C's arrangements include:

- an Executive Group comprising the Secretary and associate and deputy secretaries that deals with issues in the department and corporate management decisions. The group considers strategic issues that impact on PM&C and also monitors the performance and budget in delivering PM&C's outcomes;
- a Senior Management Group that meets weekly to discuss key business issues for PM&C, including business priorities and key commitments. The group comprises the Executive Group and division heads;
- an audit committee that is chaired by the Deputy Secretary Governance and meets quarterly. The audit committee is responsible for overseeing the department's approach to risk management, including PM&C's overall control framework;

- an internal audit function that plans and conducts audits based on risk assessments of departmental activities and direction from the audit committee;
- a risk management framework and plan that identifies and manages risk at the strategic, business and project level and also identifies and manages fraud risks;
- a fraud policy statement and fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines; and
- a governance unit that oversees PM&C's governance arrangements.

### **Areas of audit focus**

**4.368** In the light of the ANAO's understanding of PM&C's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact PM&C's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- valuation of the Prime Minister's residences;
- the valuation of the former Governors-General 'Other Entitlements' provision which is to be recognised for the first time in 2009–10;
- the valuation of employee liability provisions which rely on estimated future indices, including the assessment of future salary growth rates; and
- the management and financial reporting of the Commonwealth Heads of Government Meeting (CHOGM), which is to be funded for three years commencing in 2009–10.

**4.369** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.370** The ANAO has assessed the overall risk of material misstatement in the 2009–10 financial statements as low.

## **Audit results**

**4.371** The ANAO has completed a review of internal controls relevant to the preparation of the department's financial statements. No significant or moderate issues were identified. The areas of audit focus identified above will be reviewed as information becomes available or as part of the 2009–10 final audit.

**4.372** The ANAO did not identify any significant or moderate audit issues during either the 2008–09 audit or the 2009–10 interim audit.

## **Conclusion**

**4.373** Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that PM&C will be able to prepare financial statements free of material misstatement.

# Resources, Energy and Tourism Portfolio

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## Department of Resources, Energy and Tourism

**4.374** The Department of Resources, Energy and Tourism (RET) is responsible for improving the strength, competitiveness and sustainability of the resources, energy and tourism industries. RET achieves its objectives by providing high quality advice and services to improve their competitiveness and sustainability.

**4.375** RET's business operations include:

- the provision of advice to the Australian Government on the impact of policies in the resources, energy and tourism sectors;
- the provision of assistance to state and territory governments for resources, energy and tourism; and
- the development of policies and the delivery of programs to provide resources, energy and tourism related initiatives.

**4.376** The key characteristics of RET's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- introduction of the new financial management information system from 1 July 2009, and a decrease in the reliance on other agencies for processing accounting records;
- the management of a large range of administered programs; and
- the department's responsibility for the collection of petroleum and uranium royalties. These royalty collections are generally managed by other government jurisdictions on behalf of RET.

## Financial overview

4.377 RET's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	87	86		
Appropriation revenue	87	85		
Administered income			1 318	1 595
Administered expenses			834	1 004
Total assets	31	30	564	568
Total liabilities	29	29	51	51

RET's estimated average staffing level for 2009–10 is 440 (2008–09 : 360).

## Governance arrangements

4.378 RET has designed and implemented governance arrangements and a financial reporting framework to provide reasonable assurance about the achievement of RET's business objectives.

4.379 The key elements of RET's governance arrangements include:

- regular meetings of the Executive Board of Management to discuss key aspects of RET activities, including program management and financial performance;
- a structured framework for incorporating risk management into the broader management and business processes including the development and maintenance of a fraud control plan;
- an audit committee that meets quarterly and focuses on the enhancement of the department's control framework and risk management arrangements to improve the objectivity and reliability of externally published financial and other information; and
- an internal audit function that examines key business and financial risks and aims to assist line areas to meet their key objectives.

## Areas of audit focus

4.380 In the light of ANAO's understanding of the RET's environment and governance arrangements, that includes a financial reporting framework and



system of internal controls, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact RET's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- the valuation of assets including administered investments, particularly the valuation of the investment in Snowy Hydro Limited (SHL). The 2008–09 financial statements were qualified in respect of the valuation of the investment in SHL;
- financial sustainability in the current financial environment in the light of RET's prior year losses and limited equity reserves; and
- accrued revenue relating to petroleum royalties, given the volatility of revenue streams and their material impact on the financial statements.

**4.381** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.382** The ANAO has assessed the risk of material misstatement in 2009–10 as moderate.

## Audit results

**4.383** The valuation of the administered investment in SHL is being addressed by RET with the aim of having an appropriate methodology in place by 30 June 2010. The audit work to date in the other areas of audit focus, have not identified any significant or moderate audit issues.

**4.384** The following table provides a summary of the status of prior year issues.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	1	1	0	0	1
B	0	0	0	0	0	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>

### *Prior year issue – Category A*

#### Investment in Snowy Hydro Limited (SHL)

**4.385** In 2008–09, RET’s financial statements were qualified in respect of the valuation of the SHL investment. The valuation methodology utilised the forecast cash flow data included in the Corporate Plan of SHL in determining the fair value. The Corporate Plan was twelve months out of date and, in the ANAO’s view, while RET had made attempts to validate the cash flow data, it could not obtain sufficient documentation to support the data. As a consequence there was uncertainty about the reliability of the carrying amount of the investment for SHL and, in accordance with Australian Auditing Standards, this was regarded as a limitation on the scope of the audit.

**4.386** RET is investigating alternate strategies to obtain a fair value for the administered investment as well as investigating means to ensure Corporate Plan data can be appropriately validated. This matter will be reviewed as part of the 2009–10 final audit.

### **Conclusion**

**4.387** The ANAO has found that, subject to the resolution of the abovementioned issue, RET’s key internal controls were operating satisfactorily to provide reasonable assurance that RET will be able to prepare financial statements free of material misstatement.

# Treasury Portfolio

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## The Treasury

**4.388** The Department of the Treasury (the Treasury) is the primary advisory body to the Australian Government on economic policy and development. The Treasury develops and implements policies to improve the wellbeing of the Australian people, including by achieving strong, sustainable economic growth, through the provision of advice to the Australian Government and the efficient administration of federal financial relations.

**4.389** The Treasury's business operations include:

- monitoring and assessing economic conditions and prospects, and providing advice on the formulation and implementation of effective macroeconomic policy;
- providing advice on budget policy issues to promote effective Government spending arrangements;
- addressing taxation and retirement income arrangements through the provision of advice and assisting in the formulation and implementation of taxation and related policies and legislation; and
- providing advice on policy processes and reforms that promote a secure financial system and sound corporate practices.

**4.390** The key characteristics of Treasury's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- the federal financial relations framework as agreed by the Council of Australian Governments (COAG) and legislated under the *Federal Financial Relations Act 2009*. Under this framework, payments are made by the Commonwealth Treasury to and through, State and Territory treasuries and are reported in the Treasury's financial statements. Individual policy agencies continue to be responsible for the non-financial performance of programs and periodically advise the Treasury of details of specific purpose payments and amounts payable under National Partnership Agreements;
- a complex and dynamic environment associated with the recent global economic downturn. The Treasury's responsibilities include monitoring and providing advice in relation to the guarantees of deposits and

wholesale funding, and the temporary and voluntary guarantee over state government borrowing (from 31 March 2010 no new wholesale funding arrangements have been entered into). The Treasury is also responsible for administering the Special Purpose Vehicle, Ozcar, to address credit constraints; and

- the Standard Business Reporting project (SBR) aimed at reducing the regulatory burden facing business, the costs of which will be reported in Treasury's financial statements.

## Financial overview

4.391 The Treasury's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	167	153		
Appropriation revenue	166	149		
Administered income			12 412	4 711
Administered expenses			89 192	54 061
Total assets	123	117	30 718	28 700
Total liabilities	49	47	14 504	9 043

Treasury's estimated average staffing level for 2009–10 is 1 005 (2008–09 : 932).

## Governance arrangements

4.392 The Treasury has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance over the achievement of the Treasury's business objectives. These arrangements support the Treasury in meeting its financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative arrangements.

4.393 Key elements of the Treasury's corporate governance arrangements 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 on corporate governance, internal audit, external audit, risk management and fraud faced by the Treasury;
- a comprehensive and coordinated framework for incorporating risk management into broader management and business processes;
- an internal assurance function that involves a planned risk based coverage of the Treasury's activities; and
- a periodic fraud risk assessment undertaken in line with the Commonwealth Fraud Control Guidelines.

### **Areas of audit focus**

**4.394** In light of the ANAO's understanding of the Treasury's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact the Treasury's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- the Australian Government guarantees over State and Territory borrowings;
- the administration of National Partnership payments to the States which are reported in Treasury's financial statements;
- the Special Purpose Vehicle, Ozcar;
- arrangements for a significant concessional loan to Indonesia; and
- recognition and capitalisation of the internally generated software asset under construction (the SBR project).

**4.395** We will continue to provide audit coverage of the following areas which have previously been identified as significant to the financial statements:

- the Australian Government deposit and wholesale funding guarantees;
- recognition of General Revenue Assistance payments, in particular the Goods and Services Tax (GST) to the States and Territories; and

- follow-up of progress against the ANAO 2008–09 finding in relation to the need to improve the segregation of duties and reconciliations in processing employee expenses.

**4.396** As outlined in Chapter 3, the ANAO continues to review agencies’ IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.397** The ANAO has assessed the risk of material misstatement in the preparation of the 2009–10 financial statements as moderate.

## Audit results

**4.398** The ANAO has commenced work in the areas of audit focus and confirmed that the 2008–09 finding relating to employee processes has been resolved. Our audit has identified one moderate audit issue relating to the administration of the National Partnership payments to the States and Territories, details of which are outlined below.

**4.399** The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	0	0	0	0	0	0	0
B	1	0	0	1	(1)	1	1
<b>Total</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>(1)</b>	<b>1</b>	<b>1</b>

#### *Resolved moderate audit issue – Category B*

Employee processes – segregation of duties and reconciliations

**4.400** The ANAO noted in 2008–09 that a number of reconciliations between HR reports and the FMIS to verify the completeness and accuracy of employee financial information were not signed and dated as being reviewed and associated supporting documentation was inadequate. The ANAO also observed that employee related transactions were processed into the HRMIS

by a single officer without being reviewed. This moderate risk issue has now been satisfactorily resolved by the Treasury.

*New moderate audit issue – Category B*

National Partnership payments

**4.401** The ANAO reported one new moderate control weakness during the interim phase of the 2009–10 audit. This was in relation to the National Partnership payment arrangements.

**4.402** 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, National Partnership payments and general revenue assistance to the States and Territories through monthly payments from the Treasury to State and Territory Treasuries. These payments are reported in the Treasury financial statements. The *Federal Financial Relations Act 2009* (FFR Act) was enacted to give legislative effect to this framework. The FFR Act provides for the Treasurer to determine in writing the financial assistance payable and requires that in making each determination, the Treasurer must have regard to the Intergovernmental Agreement Federal Financial Relations (IGA) and any other written agreement. The IGA provides an overarching framework for the financial transfers between the Commonwealth and the States and Territories, and related collaboration on policy development and service delivery.

**4.403** Our interim audit identified that the Treasury did not maintain a complete central register of agreements and associated plans to support the National Partnership payments and reporting obligations under the FFR Act. In the absence of a central register of all agreements and associated details, there is insufficient evidence that the Treasurer's monthly payment determinations had full regard to all written agreements between the Commonwealth and the States and Territories.

**4.404** In addition, a schedule of the IGA requires that a detailed list of information be provided by the Treasury to each of the States and Territories, prior to a payment being made. This information should include:

- the purpose of each component of the payment;
- any conditions imposed on each component of the payment; and
- any change to the estimated amount of annual payment.

**4.405** This information provides support for the accounting treatment of these payments. As the Treasury was not complying with these reporting requirements, there is an increased risk that the payments may not be correctly reported in the Treasury financial statements.

## **Conclusion**

**4.406** 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 the Treasury can prepare financial statements free of material misstatement.

## **Australian Office of Financial Management**

**4.407** The Australian Office of Financial Management (AOFM) is a specialised agency responsible for the management of Australian Government debt. The AOFM also manages the Government's cash balance and invests in financial assets.

**4.408** The AOFM's business operations include:

- managing the Australian Government's daily cash balances through short-term borrowings and investments;
- undertaking investments in financial assets in accordance with Government policy objectives;
- managing its portfolio of debt and financial assets cost effectively, subject to acceptable risk; and
- supporting the efficient operation of Australia's financial system.

**4.409** The key characteristics of AOFM's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- an increase in the volume of investment activity of financial assets and issuance of financial liabilities, that are material to both the agency and the consolidated financial statements;
- recommencement of the issuance of Treasury Indexed bonds including through a syndication process;
- material and complex financial assets and liabilities and their associated fair value assessment; and



- a complex financial statement process that will include first-time disclosures for financial instruments under the amended AASB 7 *Financial Instruments: Disclosures*.

## Financial overview

4.410 The AOFM's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	15	6		
Appropriation revenue	13	8		
Administered income			2 217	3 332
Administered expenses			6 613	4 962
Total assets	13	18	26 983	38 321
Total liabilities	2	2	154 102	107 314

AOFM's estimated average staffing level for 2009–10 is 37 (2008–09 : 31).

## Governance arrangements

4.411 AOFM has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of AOFM's business objectives. These arrangements support the achievement of AOFM's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.412 The key elements of the AOFM's arrangements include:

- an advisory board accountable to the Secretary of the Treasury that meets at least quarterly and provides general counsel and guidance on debt management policy, operational strategy and performance of the AOFM;
- a governance committee framework, including an audit committee which focuses attention on internal audit, external audit, fraud control and the statutory financial statements. Other committees include:
  - an Executive Committee that coordinates the overall management of the agency, including the consideration of strategic issues;

- an Asset and Liability Committee that advises the Chief Executive Officer on operational debt policy and financial management issues; and
  - an Operational Risk Committee that manages operational risk of the agency. This committee recommends and determines compliance priorities and control procedures and oversees the identification, categorisation and prioritisation of operational risks.
- an internal audit function that provides a risk based coverage of AOFM’s activities;
  - a framework for incorporating risk management into AOFM’s broader management and business processes; and
  - a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

### **Areas of audit focus**

**4.413** In light of the ANAO’s understanding of the AOFM’s environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO’s audit approach identified particular areas of audit focus that have the potential to significantly impact the AOFM’s financial statements. Areas highlighted for specific audit coverage in 2009–10 are the:

- accounting treatment of newly issued financial instruments (Treasury Indexed Bonds);
- capacity of AOFM to manage an increase in the volume of the issuance of debt instruments (Treasury Bonds and Treasury Notes);
- financial instrument presentation and disclosures, including the impact of the revised AASB 7 and AASB 101 *Presentation of Financial Statements*; and
- a scheduled upgrade of the debt and financial asset management system.

**4.414** We will continue to provide audit coverage of the following areas which have previously been identified as significant to the financial statements:

- AOFM’s control environment and the establishment of adequate controls to enable compliance with aspects of relevant financial management legislation;
- the fair value measurement of financial assets and financial liabilities;
- recognition of gains and/or losses on divestment of legacy debt hedge portfolio assets and the fair value impact on the financial statements; and
- AOFM’s internal assurance activities including the Certificate of Compliance process and fraud prevention activities.

**4.415** The ANAO has assessed the risk of material misstatement in the 2009–10 financial statements as moderate.

## **Audit results**

**4.416** The ANAO has commenced work in a number of the areas of audit focus, including a review of authorisation and reconciliation controls relating to Commonwealth Government Securities (Treasury Bonds, Treasury Indexed Bonds and Treasury Notes) and investments under s39 of the FMA Act.

**4.417** The areas of financial instruments and fair value measurements, including presentation and disclosures, will be reviewed as part of the 2009–10 final audit. Prior to year-end, a review of shell accounts will be performed, including the classification of assets and liabilities held at fair-value, against the three tier fair-value hierarchy detailed in *AASB 7 Financial Instruments: Disclosures*.

**4.418** The AOFM has completed a scheduled upgrade to its debt and financial asset information management system. The ANAO will complete a review of this upgrade prior to year-end.

**4.419** No significant or moderate audit issues have been identified, as was the case in 2008–09.

## Conclusion

**4.420** Based on the audit work performed to date key internal controls are operating satisfactorily to provide reasonable assurance that the AOFM can prepare financial statements free of material misstatement.

## Australian Taxation Office

**4.421** The Australian Taxation Office (ATO) is the Australian Government's principal revenue management agency. In 2009–10, the ATO is expected to collect some \$260 billion in revenue, approximately 90 per cent of the Australian Government's revenue.

**4.422** The ATO's 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.

**4.423** The key characteristics of ATO's business operations that shape the ANAO's 2009–10 financial statement audit coverage include:

- a complex legislative environment, that is subject to ongoing change;
- extensive IT based business systems and associated processes;
- a self assessment regime for the collection and reporting of taxation revenues;

- a complex financial statement process that involves using data from a number of business systems and requires significant estimations in calculating the balances of a number of financial statements items; and
- financial reporting pressures and budgetary constraints that impact the ATO's financial control framework.

## Financial overview

4.424 The ATO's key financial figures are:

Key financial balances	Departmental	Departmental	Administered	Administered
	Estimated (\$m) 2009–10	Actual (\$m) 2008–09	Estimated (\$m) 2009–10	Actual (\$m) 2008–09
Net cost of services	3 007	2 936		
Appropriation revenue	3 007	2 912		
Administered income			261 621	270 038
Administered expenses			13 780	21 999
Total assets	885	921	28 156	25 491
Total liabilities	896	937	6 037	6 879

ATO's estimated average staffing level for 2009–10 is 21 553 (2008–09 : 22 035).

## Governance arrangements

4.425 ATO has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of ATO's business objectives. These arrangements support the achievement of ATO's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

4.426 The key elements of the ATO's arrangements 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 committee that meets at least monthly and has a formal bi-annual corporate governance assurance process;

- a governance committee framework, including an audit committee. Some of these committees are sub committees of the executive committee;
- an internal audit function providing an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives;
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and the Commissioner's annual Certificate of Compliance;
- a framework for incorporating risk management into ATO's broader management and business processes; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

## **Areas of audit focus**

**4.427** In the light of the ANAO's understanding of the ATO's environment and governance arrangements, that includes a financial reporting regime and a system of internal controls, the ANAO's audit approach identified particular areas of audit focus that have the potential to significantly impact the ATO's financial statements. Areas highlighted for specific audit coverage in 2009–10 are:

- ATO's enhancement of 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 components relating to various aspects of ATO's business, such as Income Tax, Superannuation and Fringe Benefits Tax (FBT). As a consequence, the review of the implementation of the Change Program, business systems and associated processes particularly in relation to the Income Tax module, and related data conversion, system interfaces and release management, forms a significant part of the ANAO's audit examination of internal controls;
- valuation risks including impairment of receivables and all estimation processes arising from the impact of economic conditions on major

items in the financial statements. Arrangements will include engaging independent experts (actuaries) to obtain the necessary level of assurance; and

- legislative compliance, including ATO's changes to Superannuation Co-contributions processes to ensure alignment with legislative requirements and the implementation of measures to ensure legislative compliance with *The Constitution*, in light of a breach of section 83 of *The Constitution* identified in previous years.

**4.428** We will continue to provide audit coverage of the following areas which have previously been identified as significant to the financial statements:

- ATO's control environment and the establishment of adequate controls to enable compliance with aspects of relevant financial management legislation;
- taxation administration for the collection and reporting of taxation revenues, including processes associated with self assessment and voluntary compliance;
- ATO's internal assurance activities including the Certificate of Compliance process, Integrity Assurance, and fraud prevention activities;
- complex estimation and allocation processes associated with financial reporting where there is the application of judgement and specialist knowledge;
- significant IT systems from which a number of financial statement balances are sourced; and
- ATO's financial management of the Change Program, capitalisation and impairment of Change Program internally developed software costs and relevant implementation matters identified in the ANAO's performance audit report 2009–10 No 8-*The Australian Taxation Office's Implementation of the Change Program: a strategic overview*.

**4.429** As outlined in Chapter 3, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**4.430** The ANAO has assessed the risk of material misstatement in the 2009–10 ATO financial statements as high.

## **Audit results**

**4.431** The ANAO’s interim audit has focused on ATO’s control environment, taxation administration for the collection and reporting of taxation revenue, internal assurance activities, and key IT systems used as the source of data for financial statement balances. We have also reviewed actions taken by the ATO to address prior year audit findings. The audit has identified three moderate audit issues relating to access and security in relation to the Change Program and ATO’s mainframe computer. Details of these matters are outlined below. The ANAO will complete audit coverage of areas identified as significant to the financial statements, including ATO’s enhancement of its business systems, matters associated with legislative compliance, ATO’s financial management of the Change Program and valuation of provisions relating to non-collectable receivables and estimation processes during the 2009–10 final audit.

### *Significant audit issue—Category A*

Outstanding legislative audit finding from prior years

**4.432** The 2008–09 financial statements made reference, in Note 24C, to a number of breaches of section 83 of *The Constitution*. These breaches were identified by the ATO during the 2008–09 Certificate of Compliance process. The note to the financial statements indicates that, from time to time, as a result of processing errors outside the assessment process, incorrect payments are made by the ATO. In these circumstances a payment is made to a taxpayer without any legislative basis, representing a breach of section 83 of *The Constitution* which requires that no money shall be drawn from the Treasury of the Commonwealth except under an appropriation made by law.

**4.433** A total of 1 097 incorrect payments totalling \$9.0 million were identified during 2008–09 comprising a very small percentage of some 22 million payments made during the year. At the time of signing the 2008–09 financial statements, over 96 per cent of the incorrect payments had been recovered.

**4.434** The audit opinion on the financial statements was unqualified, however the opinion included a reference to the breach of section 83 of *The Constitution* under “Other Legal and Regulatory Requirements”. The ATO is currently reviewing available measures to address this issue.



**4.435** The following table provides a summary of the status of prior year issues as well as the 2009–10 audit issues raised by the ANAO in the interim phase of the audit.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2009 interim audit)	Findings resolved (at the time of 2009 final audit)	New findings (during 2009 final audit)	Findings outstanding (at end of 2009 final audit)	Findings resolved (at the time of 2010 interim audit)	New findings (during 2010 interim audit)	Closing position (at end of 2010 interim audit)
A	1	-	-	1	-	-	1
B	7	(3)	1	5	(1)	3	7
<b>Total</b>	<b>8</b>	<b>(3)</b>	<b>1</b>	<b>6</b>	<b>(1)</b>	<b>3</b>	<b>8</b>

#### *Outstanding significant audit finding from prior years*

##### Security Classification

**4.436** Since the 2006–07 audit of ATO’s management of security, the ANAO has continued to observe that the ATO is not complying with their IT Security Policy and the Australian Government Protective Security Manual (PSM) requirements for the classification, storage and transmission of protected information. Weaknesses in these security controls increase the risk that persons without appropriate clearance or access rights may have access to information and/or information may be inappropriately distributed.

**4.437** The ANAO acknowledges that ATO is making progress in implementing controls to address this matter. The initiatives being taken by the ATO include an information security review, the electronic scanning of emails and the establishment of improved controls for the storage of protected information.

**4.438** Following a risk assessment, the Commissioner of Taxation issued a waiver against certain minimum standards of the PSM and the Australian Government Information and Communication Technology Security Manual (ACSI 33).

**4.439** In addition, an ATO internal audit on the storage of protected information has been completed and the internal audit report made a number of recommendations for improvement. The ATO is reviewing the report with a view to implementing the majority of the report’s recommendations.

**4.440** The ANAO will monitor ATO's progress in addressing this matter as part of the 2009–10 final audit.

*Moderate audit issues – Category B*

**4.441** In the final phase of the 2008–09 audit the ANAO reported five moderate audit issues. During the 2009–10 interim audit, the ANAO observed that the ATO had effectively addressed the moderate audit finding in relation to Mainframe Access—RACF group maintenance.<sup>37</sup> Action taken by the ATO includes defining and communicating the administrative responsibilities for RACF, and regularly reviewing and updating RACF listings.

*Ongoing moderate audit findings from prior years*

**4.442** Our 2009–10 interim audit identified that reasonable progress was being made to address four ongoing moderate risk matters. The status of each of these issues is outlined below.

*Change Program*

**4.443** The ATO is continuing to implement changes to 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 replacement systems and enhancements relating to various aspects of ATO's business, such as Fringe Benefits Tax (FBT), Superannuation Co-contributions and Income Tax. 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.

**4.444** During the 2008–09 final audit a review of aspects of the Superannuation Co-Contributions system release identified that while a number of improvements had been made, continuing weaknesses were identified in a number of areas. These included security issues relating to the management of privileged user access rights, the operating effectiveness at system release of reconciliations that provide assurance over the number of transactions received from system interfaces, and the transfer of data through various system components. There were also departures from key elements of

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<sup>37</sup> The Resource Access Control Facility is a mainframe operating system that provides access control and audit functionality for ATO's mainframe.

standards and guidelines on their testing process, including the use of the testing management tool.

**4.445** These matters will be reviewed during audit testing of the Income Tax Processing release to be undertaken as part of the 2009–10 final audit.

#### Superannuation Co-contributions

**4.446** The ATO is working to implement a number of changes to systems, forms, information collection and business process to address system defects that had resulted in delays in payments and to enable compliance with the existing Superannuation Co-contributions legislation. Given the complexity of the changes required to comply with the legislation, the ATO is working towards implementing these changes by July 2010. The ANAO will continue to monitor this issue, and review remedial measures being taken to address potential compliance risks as part of the 2009–10 final audit.

#### *New moderate audit issues*

##### Change Program – privileged account management

**4.447** During the 2009–10 interim audit, the ANAO identified issues relating to a large number of active accounts which have high level access privileges. These privileges include the ability to control and change passwords, access files, and install new programs.

**4.448** The ANAO also observed several control weaknesses over the management of privileged accounts, including password management not being in accordance with ATO policy and delays in the removal of unused account access.

**4.449** A large number of active accounts with a high level of privileges and weaknesses in the management of these accounts increases the risk that data may be inappropriately created, modified or deleted.

##### Mainframe security control

**4.450** RACF is a mainframe operating system that maintains critical management information that is used to manage and monitor all mainframe users. RACF also facilitates segregation of duties by ensuring users are not assigned to incompatible groups. Within the ATO, users are granted access to groups through an ATO developed software tool for administering RACF access.

**4.451** During the 2009–10 interim audit, the ANAO noted that the potential existed for this tool to be circumvented by over 650 users. This situation may

result in the granting of inappropriate mainframe access, increasing the risk of unauthorised access to financial and taxpayer information. During the 2009–10 audit, the ANAO observed an instance where ATO's controls had detected that this tool had been bypassed, resulting in the assignment of mainframe users to incompatible groups.

**4.452** The ATO addressed this specific instance and advised that it is reviewing RACF access on a monthly basis. The ANAO will review progress on this issue during the 2009–10 final audit.

#### Change Program – security management

**4.453** The ATO Change Program involves the development and implementation of the Integrated Core Processing (ICP) system which, amongst other things, is used to process income tax returns. User access to the ICP is managed through a set of systems and applications. User roles and permissions are communicated between these systems and applications to enable access to the ICP and to provide for the appropriate segregation of duties within the Change Program environment.

**4.454** During the 2009–10 interim audit, the ANAO identified a significant number of discrepancies between these systems and applications. The effective control of access to ICP requires that the number of discrepancies be minimised through regular monitoring and review. The audit also identified that responsibilities for managing ICP access controls, including reconciling discrepancies between the systems and applications, have not been formally assigned. This situation increases the security risks to the Change Program environment, such as unauthorised access, which have the potential to impact the accuracy and completeness of financial data.

**4.455** The ATO has advised that a clean up of the system and application discrepancies has been undertaken. However, ongoing responsibilities for ICP access controls are still to be developed and formally assigned.

**4.456** The ANAO will review progress on this issue during the 2009–10 final audit.

## Conclusion

**4.457** The ANAO found that the majority of the ATO's key internal controls were operating satisfactorily. Our 2009–10 interim audit identified a number of control issues that require management attention to reduce the risk of material misstatement in ATO's financial statements. The ATO has responded positively to the ANAO's findings and associated recommendations.

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Ian McPhee  
Auditor-General

Canberra ACT  
24 June 2010



# Appendices





## Appendix 1: Agencies covered by this report<sup>38</sup>

Department of Agriculture, Fisheries and Forestry

Attorney–General’s Department

Australian Customs and Border Protection Service

Department of Broadband, Communications and the Digital Economy

Department of Climate Change and Energy Efficiency

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 Resources, Energy and Tourism

Department of the Treasury

Australian Office of Financial Management

Australian Taxation Office

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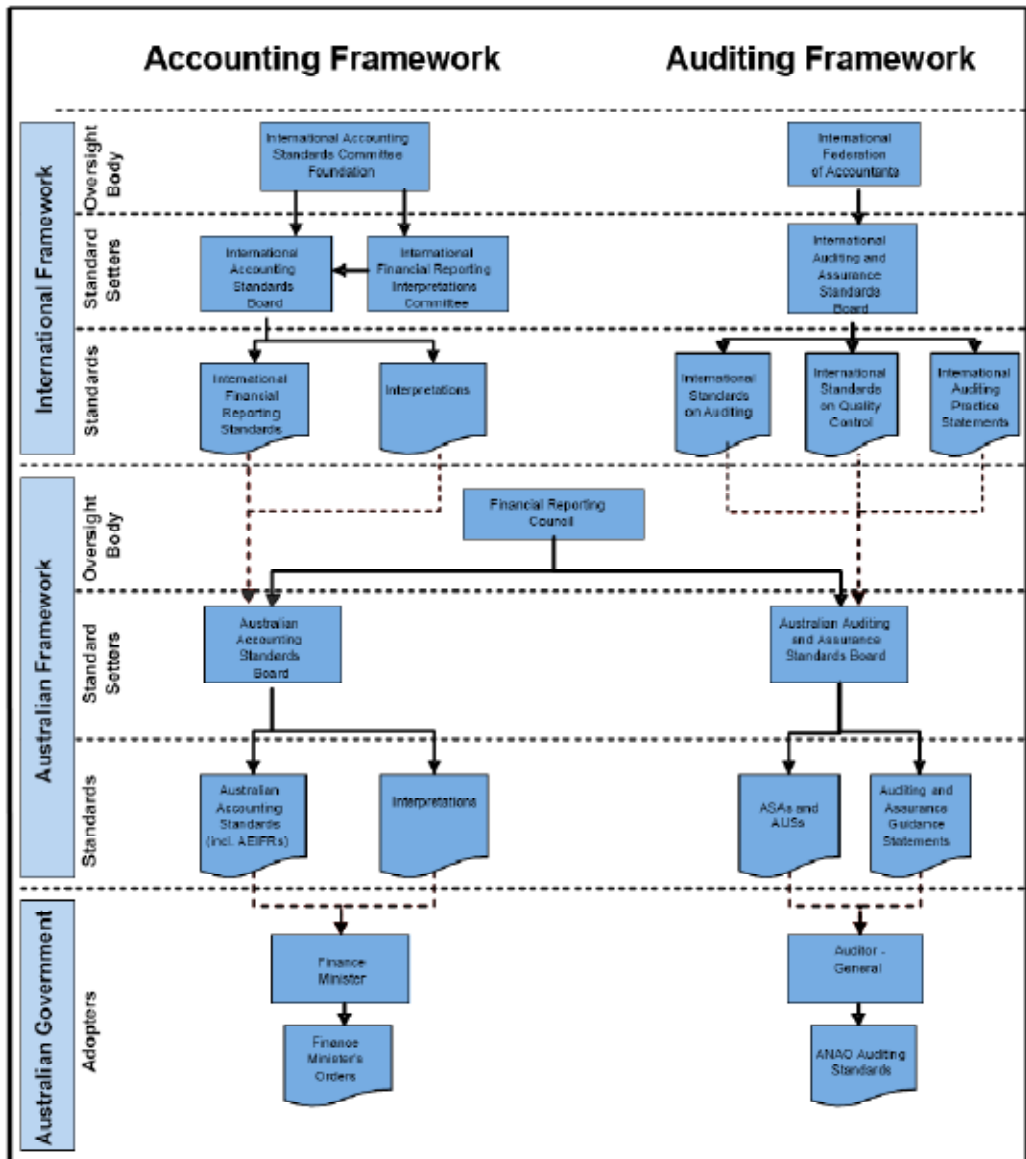
<sup>38</sup> Agencies are grouped by portfolio.

## Appendix 2: The Accounting and Auditing Standards Frameworks

The figure below depicts the standard setting framework, for accounting and auditing, in the Australian Government context.

Figure A 1

### Standard Setting Framework

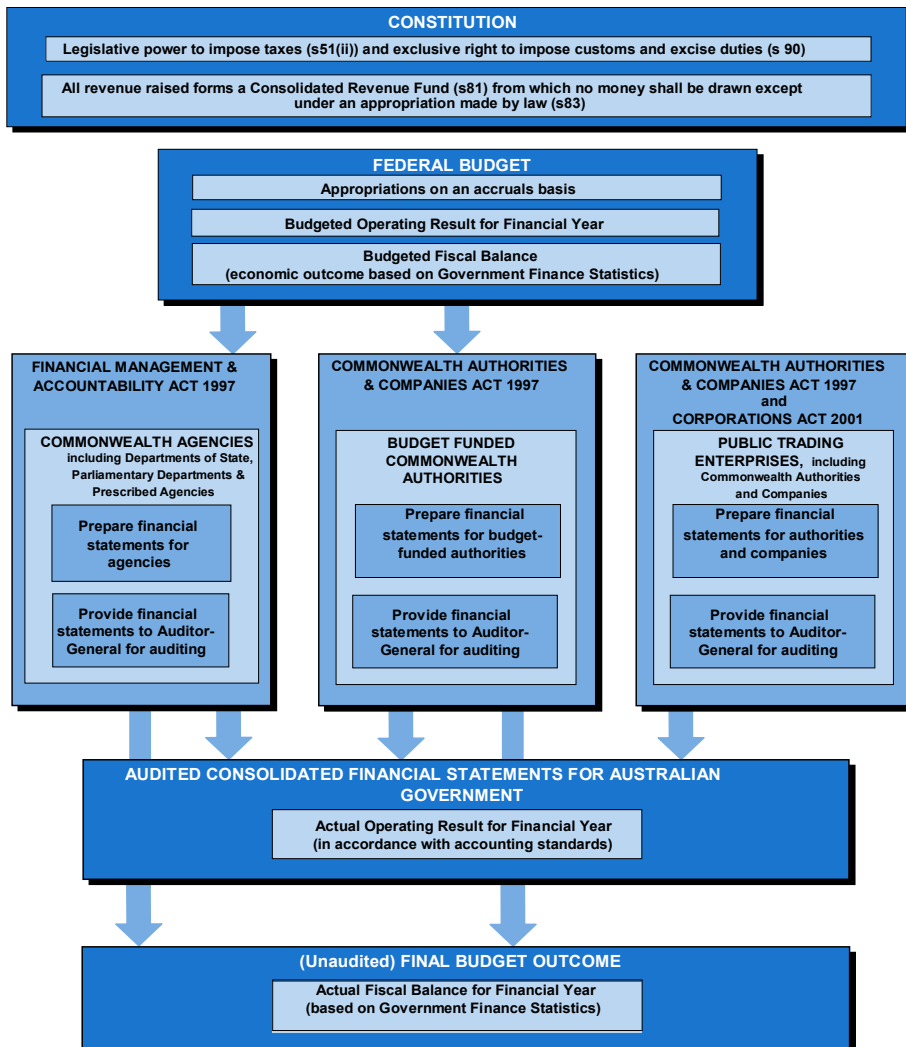


## Appendix 3: The Financial Reporting Framework

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 the Finance Minister's Orders (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 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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