The Auditor-General
Audit Report No.48 1999–2000
Performance Audit

Follow-up audit of Department of Education, Training and Youth Affairs (DETYA) International Services

Department of Education, Training and Youth Affairs

Australian National Audit Office

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Audit Office

Canberra ACT
19 June 2000

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a follow-up performance audit in the Department of Education, Training and Youth Affairs (DETYA) in accordance with the authority contained in the *Auditor-General Act 1997.* I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Follow-up audit of Department of Education, Training and Youth Affairs International Services.*

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

Yours sincerely

P. J. Barrett
Auditor-General

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

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For further information contact:
The Publications Manager
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Telephone (02) 6203 7505
Fax (02) 6203 7798
Email webmaster@anao.gov.au

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Audit Team

Ivan Jurkovic
Ann Thurley
Steven Lack

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Abbreviations/Glossary

AIRS	Australian International Recruitment Service
ANAO	Australian National Audit Office
APS	Australian Public Service
ASL	Average Salary Level
CSO	Community Service Obligation
DETYA	Department of Education, Training and Youth Affairs
DIS	DETYA International Services
DoFA	Department of Finance and Administration
JCPAA	Joint Committee of Public Accounts and Audit
SAP	SAP is a financial and/or human resource management information system that is widely used by Commonwealth government agencies.

Audit Findings and Conclusions

1. Introduction

Background

1.1 The Department of Education, Training and Youth Affairs (DETYA) International Services is an international consulting and technical assistance service. It has been operating in the international consultancy market since 1993.

1.2 The primary purpose of DETYA International Services (DIS) is to promote abroad Australian expertise in education and training systems and services. It aims to achieve this through:

- securing contracts for education sector development projects financed by international aid and development agencies (for example, the World Bank and the Asian Development bank); and
- supporting study tours to Australia that showcase Australian innovation and practice in education and training.

DIS also manages a community service obligation (CSO) of the Government, that is, the Australian International Recruitment Service (AIRS) which aims to promote equitable representation of Australian experts (mainly from universities) in the United Nations and other international agency posts, by tracking and disseminating job vacancies in those agencies. This activity is performed under an international agreement signed by the Commonwealth.

Follow-up audit

1.3 In 1997–98 an ANAO audit of DIS[1] was undertaken to examine its operations with a view to identifying the administrative issues and difficulties experienced by the Department in establishing a commercial entity and its subsequent operation within the framework of the Australian Public Service (APS).

1.4 The report of that audit, Audit Report No.35 *DEETYA International Services*, was tabled in Parliament in March 1998.

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1 At that time, DIS was part of the then Department of Employment, Education, Training and Youth Affairs (DEETYA).

1.5 The Joint Committee of Public Accounts and Audit (JCPAA) reviewed the report in March 1999. In its report, No.367, the JCPAA made one recommendation relevant to DIS as follows:

> *the Committee recommends a follow-up audit of the international operations of DETYA in order to assess the effectiveness of the cost recovery operational model.*

1.6 Report No.35 had made the following specific recommendation regarding costing issues:

> *The ANAO recommends that DIS reviews and improves the costing methodology in a way which ensures that the full costs of production are properly determined and taken into account and therefore provide a sound basis for decisions on appropriate pricing strategies (Recommendation No.8).*

1.7 This recommendation was made as a result of a number of findings dealing with costing issues contained in Chapter 6 of the ANAO report. These findings included the following:

- DIS did not include specific allowance in its tenders to cover either the direct salaries or on-costs of its management and administration staff (paragraph 6.6);
- there was no indication that DIS had sought to determine whether the general Department of Finance and Administration (DoFA) multiplier or the Department's own multiplier for costing new policy proposals was the appropriate multiplier given DIS' particular circumstances (paragraph 6.8);
- DIS indicated that the accumulation of a cash deficit would reflect other factors such as DIS' non-commercial activities. However, the ANAO considered that if DIS wished to define these activities as contributing to its cash surplus/deficit then the activities should be fully costed and taken into account in determining the surplus/deficit (paragraph 6.12); and
- ongoing effective commercial operation, or effective management of a full cost recovery regime, is not feasible without systems for accrual accounting and full costing (paragraph 6.24).

1.8 These findings are reflected in the criteria for this follow-up audit as described below.

Audit objective

1.9 The objective of the follow-up audit was to review the effectiveness of the DIS cost recovery operational model.

Audit methodology

1.10 The ANAO undertook discussions at DETYA's National Office with relevant staff. Relevant documentation was provided by DETYA staff and reviewed by the ANAO.

1.11 The audit was conducted in conformance with ANAO auditing standards at a cost of $21 000.

Audit criteria

1.12 The ANAO assessed whether the current costing approach:

- properly determines the full costs of production;
- includes an allowance to cover the costs of DIS management and administrative staff;
- allows the production of internal financial reports, which are prepared on an accrual basis and cover the full range of accrued cost elements;
- provides full accrual financial information to assist informed business decision-making; and
- separately identifies costs of community service obligations and departmental functions from commercial activities.

1.13 The findings against each of these criteria are discussed under separate headings in the next chapter.

2. Audit findings

Costs of management and administrative staff

2.1 In Report No.35 the ANAO stated that:

> *DIS did not include specific allowance in its tenders to cover either the direct salaries or on-costs of its management and administration staff.*

2.2 DIS now includes a minimum 15 per cent loading in tenders to cover the costs of management and administrative staff to address this issue[2].

2.3 However, there has been no change to DIS' project cost calculation methodology from that previously advised by the Department to the JCPAA in August 1998. This advice provided details on the progress made by the Department in addressing Recommendation No.8 of the ANAO's report as follows:

> *As the Department's SAP accrual accounts progressively make corporate cost data available, these will replace the currently attributed costs … In addition, DIS has also implemented a new time utilisation system to better identify specific direct and indirect costs of staff time … In the meantime, DIS continues to use the Department of Finance and Administration's (DoFA) formula and, where appropriate, the contract cost of external consultants, with an additional (minimum) 15 per cent loading, as the base for the pricing of consultant services. The DoFA formula covers the salary and overhead cost of direct staffing used in projects, and the loading supports the costs of DIS administration and the costs of unsuccessful bids.*

2.4 The ANAO found that the Department is yet to implement the proposed project costing methodology as previously advised to the JCPAA. The proposed methodology would improve DIS' direct project input cost estimations by calculating:

- for the costing of DIS staff on projects, the full costs including salary and direct and indirect overheads of a Departmental average salary level (ASL) unit, based on accrual accounting data. (This will substitute for the DoFA overhead formula multiplier of 2.54 times direct salaries, currently in use); and

[2] The 15 per cent loading is based on management estimates of these costs.

- for DIS administrative costs (operating overheads), the broad categories of costs attributed through the Department's SAP[3] based accrual accounts to DIS operations, covering all business development, administrative overheads, downtime, unsuccessful bids and future liabilities. (This will substitute for the 15 per cent estimate currently used).

2.5 While DIS could be using more sophisticated project estimates costing models, based on actual costs from accrual accounts rather than using the broad DoFA overhead formula multiplier (hereinafter referred to as the DoFA formula), this issue is not now considered significant as:

- DIS staffing is planned to reduce to a very low level (potentially 1.5 ASL) and it would be unlikely that a more sophisticated project costing arrangement would be cost effective at this level of operation; and
- in a macro sense, full accrued costs and project revenue are matched in financial statements prepared for management, thereby providing a broad measure of the appropriateness of the DoFA formula.

Accrual financial reports

2.6 The ANAO noted in Report No.35 that:

> *effective management of a full cost recovery regime, is not feasible without systems of accrual accounting and full costing ….*

2.7 DIS now prepares financial reports for management that include internal financial statements that cover the full range of accrued cost elements. The notes to these statements indicate that '*the financial statements have been prepared in accordance with the Financial Statements of Departments Guidelines … issued by the Minister for Finance*'.

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3 SAP is a financial and/or human resource management information system that is widely used by Commonwealth government agencies.

2.8 DIS salary expense, for example, is calculated to take account of the following:

- cash expenditure;
- salary accrual (calculated on the basis of salary due but not paid at 30 June);
- recreation leave provision (calculated on leave balances at 30 June);
- long service leave provision (calculated on the basis of pro rata entitlement based on years worked);
- workers compensation expense (calculated based on full time equivalent and previous year's actual expenditure);
- occupational health and safety premiums; and
- DIS corporate activities including officers time spent on departmental activities such as branch meetings or planning days.

2.9 Where appropriate, salaries used in calculations for the financial statements include a superannuation element of 16 per cent of gross salary. The accrual financial statements also include:

- provision for doubtful debts;
- corporate support costs at $5000 per ASL—a management estimate;
- creditors;
- property operating expenses—a management estimate;
- depreciation; and
- prepayments.

2.10 The ANAO noted that a number of financial statement items, such as corporate support expenses and the cost of DETYA staff on overseas projects, rely on management estimates and manual calculations outside the SAP accounting system. This reflects the fact that the use of accrual accounting has not yet fully 'flowed through' to the day-to-day operations of DIS.

2.11 However, the financial statements provide substantive financial management information which, for example, would allow DIS to determine whether the DoFA formula is appropriate given its particular circumstances, that is, one of the important costing issues raised in Audit Report No.35 (paragraph 6.8). The most recent full-year financial statements (for 1998–99) showed that DIS had made a loss—but significant action has been taken as a result, as set out below.

Accrual financial information for decision-making

2.12 DIS has used actual accrual financial information to inform business decision-making. For example, in providing a Brief to the Minister (September 1999) the Secretary noted that:

- the existing operational framework for DIS was established in September 1997. DIS' main operations were confined to regions of special significance to Australia's foreign policy;
- DIS was to recover costs over a three year period from July 1997 to June 2000 (this does not include the Australian International Recruitment Service (AIRS)—a community service obligation of the government);
- DIS had not been able to achieve full cost recovery:[4]
  - the 1997–98 deficit was $202 135; and
  - the 1998–99 deficit was $237 435;
- the primary cause of the deficits was DIS' loss of business. Factors contributing to the loss of business included:
  - (on the demand side) limiting activities to the Asia-Pacific region, which not only cut out a significant proportion of the available international market but also coincided with the Asian financial crisis; and
  - (on the supply side) outsourcing employment placement functions and subsequent administrative changes[5] significantly reduced the resource base on which the DIS business was originally founded and resulted in the loss of experienced staff who were a vital element in successful tendering; and
- the preferred option to address the deficit was to reduce DIS operations to a level that would allow DIS to respond to important opportunities, but without incurring the costs associated with active tendering for contracts.

2.13 The preferred option to reduce the level of DIS operations was agreed, and revised operating procedures were approved in October 1999. DIS staffing had reduced to 3.0 ASL in 1999–2000 and, as previously indicated, may potentially reduce further to 1.5 ASL at some time in the future.

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4 Based on accrual financial statements, including the full range of cost elements.

5 The Administrative Arrangements Order 1998 created the current Department without the employment function.

2.14 DIS management financial statements for the six months to 31 December 1999 indicate that DIS produced an operating profit for the period which gives weight to the view that the above strategies are sound.

Separation of non-commercial costs

2.15 DIS also undertakes non-commercial activities such as government CSOs. However, the time spent on these activities was not being separately identified and costed when the original audit was undertaken.

2.16 DIS has now implemented a time recording system that allows the separation of the staff costs of CSOs and departmental related functions from commercial activities.

2.17 The DIS time recording system uses a database to record staff time against:

- corporate activities;
- training;
- community service obligations (including the AIRS);
- DIS administration/finance;
- liaison and Project/Study tour preparation; and
- DIS projects (by project).

2.18 Staff complete their time records daily and aggregated records are available enabling the separation of the staff costs of CSOs and departmental functions from commercial activities.

2.19 As well, coded ledger accounts have been established that allow the separation of non-salary expenses between DIS' various activities.

2.20 The establishment of the ledger and time recording systems allows the overall costs of DIS commercial activities to be included in their internal accrual financial statements net of the costs of CSOs and corporate activities. This adequately addresses the concern raised in the original audit.

Conclusion

2.21 The ANAO concluded that the effectiveness of DIS costing methodology has improved to the point where its International Services can adequately determine the full costs of production. In particular:

- estimation of project costs still relies on the broad Department of Finance and Administration (DoFA) costing percentages but now includes an allowance to cover the specific costs of DIS management and administrative staff. While DIS could be using more sophisticated project estimates costing—based on actual costs from accrual accounts rather than the broad DoFA formula—the issue is not considered to be of major concern as:

  - DIS staffing is planned to reduce to a very low level (potentially 1.5 ASL) and a more sophisticated project costing arrangement would be unlikely to be cost effective at this level of operation; and
  - in a macro sense, full accrued costs and project revenue are matched in financial statements prepared for management thereby providing a broad measure of the appropriateness of the DoFA formula;

- internal management financial statements are prepared for DIS on an accrual basis, and cover the full range of accrued cost elements;
- DIS is using full accrual financial information to inform business decision making;
- a time recording system has been implemented that allows the separation of the costs of CSOs and departmental functions from commercial activities; and
- coded ledger accounts have been established that allow the separation of non-salary costs between the various activities of DIS.

DETYA response

2.22 DETYA advised that it was:

> *...pleased to note the report's overall conclusion that the DIS costing methodology can now adequately determine the full costs of production [and] that concerns raised in [the ANAO's] earlier report have been satisfactorily addressed, or are no longer considered significant because of the appropriateness of the DoFA formula being used by DIS.*

Canberra ACT
19 June 2000

P. J. Barrett
Auditor-General

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