Payroll Management

Canberra ACT
15 November 2001

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken an across agency Assurance and Control Assessment audit 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 *Payroll Management.*

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

Audit Team
Edward Hay
Peter Green

Contents

Abbreviations/Glossary

ACA	Assurance and Control Assessment
ANAO	Australian National Audit Office
APS	Australian Public Service
AWA	Australian Workplace Agreement. A written agreement between the employer and the employee that outlines the employee's terms and conditions of employment.
CAC Act	*Commonwealth Authorities and Companies Act 1997*
Certified Agreements	Collective agreements negotiated between an employer and a union, or groups of employees that have been certified by the Australian Industrial Relations Commission detailing employee terms and conditions.
CEO	Chief Executive Officer
Commonwealth Procurement [1] Guidelines (1998)	Guidelines that clarify what is required and expected in Commonwealth procurement activity.
CSA	Control Self-Assessment
Finance	Department of Finance and Administration
FMA Act	*Financial Management and Accountability Act 1997*
FTE	Full–Time Equivalent
HDA	Higher Duties Allowance
IT	Information Technology
KPI	Key Performance Indicator
MAB/MIAC	Management Advisory Board/Management Improvement Advisory Committee
PS Act	*Public Service Act 1999*

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[1] At the time of the audit, the 1998 version of the Commonwealth Procurement Guidelines was the current version. Recently, a new version dated September 2001 has been released.

Public Service Commissioner's Directions (1999)	Directions issued under the PS Act for the purpose of: • ensuring the APS incorporates and upholds the APS Values; • determining the scope or application of the APS Values; and • ensuring appropriate procedures are established by agency heads when determining whether an APS employee has breached the Code of Conduct.
WR Act	*Workplace Relations Act 1996*

Summary and Recommendations

Summary

Introduction

1. Payroll management is concerned with all aspects of the arrangements that are in place to ensure that employees of an organisation receive remuneration which is in accordance with their terms of employment, is lawful and is appropriately recognised in the financial statements of the organisation. Commonwealth organisations spent in excess of $15 billion in staff costs[2] in 1999–2000, which accounted for over 10 per cent of total annual Commonwealth expenditure.

2. The payroll activity includes all processes required to pay salaries and wages in accordance with organisation policies, including Certified Agreements, Australian Workplace Agreements (AWAs), and government regulations.

3. By its nature, payroll processing is considered by management as a lower risk area given the prevalence of routine transactions associated with such processing. Notwithstanding this risk assessment, payroll management arrangements have not been exempt from the drivers of change within the public sector which present challenges for Chief Executive Officers (CEOs), relevant management and other staff concerned.

4. In recent years, payroll management in public service organisations has had to respond to the impact of:

- the introduction of the *Public Service Act 1999* (PS Act);
- the introduction of Certified Agreements and an increasing number of AWAs;
- agencies having to implement their own payroll systems as the Department of Finance and Administration (Finance) no longer processes payroll payments on behalf of other agencies[3];
- the technological developments in human resource management information systems;

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[2] Consolidated Financial Statements of the Commonwealth, for the year ended 30 June 2000.

[3] Agencies are defined in the *Financial Management and Accountability Act 1997* as Departments of State, Parliamentary Departments and prescribed agencies.

- the market testing of corporate service functions;

- the information requirements of Finance pricing reviews; and

- the implementation of accrual accounting for public sector organisations and the transfer of leave liabilities between organisations at the time employees move.

Audit objectives, criteria and coverage

5. The objectives of the audit were to:

- determine whether organisations have established effective internal control frameworks for the management of payroll operations;

- assess whether payment of salaries and related expenditures is made in accordance with the relevant terms and conditions of employment; and

- identify better practices in the management and operation of payroll systems.

6. In order to comment on the audit objectives, five criteria were developed against the components of an effective framework[4] which consists of:

- risk assessment;

- control environment;

- control activities;

- information and communication; and

- monitoring and review.

The detailed criteria are shown in Table 6, Appendix One.

7. The audit was undertaken in six organisations, two of which were subject to the requirements of the *Financial Management and Accountability Act 1997* (FMA Act) and, in respect to the terms and conditions of staff, the PS Act. The remainder were subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act) and, in respect to the terms and conditions of staff, the PS Act and their particular enabling legislation.

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[4] The components of an effective control framework are detailed in the ANAO's *Better Practice Guide to Effective Control, Control Structures in the Commonwealth Public Sector: Controlling Performance and Outcomes,* 1997.

Audit conclusion

8. The ANAO concluded that the robustness of the control framework for the management of payroll operations varied across the organisations reviewed, although most met what could be considered minimum performance standards. The audit highlighted there is scope for all organisations to improve and enhance their risk assessment arrangements and internal control frameworks.

9. Further, on the basis of limited testing, the audit did not identify any instances of payments that were not made in accordance with relevant employment terms and conditions.

10. The better practice elements of the payroll function were generally evident in those organisations which, in considering whether there was a case for, or as a result of, outsourcing the payroll function, had identified its essential elements and established a control framework for the effective operation of the payroll function. While agencies' consideration of the case for outsourcing was a positive stimulus for enhancing the control environment, this outcome can also be achieved by enhanced management attention to the payroll function.

11. The audit conclusions are supported by the key findings shown below.

Key Findings

Summary of audit findings

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

- **Risk assessment**

  —Overall, the audit found that organisations had focussed on establishing organisational or strategic risk frameworks. However, this approach had not been adopted or applied at a process level. This is particularly the case in relation to the payroll function, which is perceived to be well established and routine in nature with adequate controls in place, and therefore low risk. These perceptions, however, have not been based on regular, informed assessments of the risks to the payroll function. Organisations had not adequately recognised and addressed the heightened risk profile resulting from the changes within the Australian Public Service (APS) that have impacted specifically on payroll management and related arrangements.

  —The audit highlighted that there remains significant room for improvement in the application of risk management to payroll arrangements. To date, any consideration of payroll related risk has only related to fraud or IT issues. Undertaking a systematic process level risk assessment would allow organisations to address these deficiencies or gaps in their overall risk management framework and ensure that operational staff understand and apply the principles and better practice of risk awareness, assessment and management. It would also ensure that organisations had considered all of the potential risk areas.

- **Control environment**

  —The audit highlighted that controls in place generally centred on the more traditional areas, such as schedules of delegation, but were deficient in addressing changes in working and control processes prompted particularly by IT advances. Overall, the robustness of the control environments varied across the organisations although most met what could be considered minimum standards.

  —The audit also highlighted that improvements could be made to: policies and procedures relating to areas such as the use of e-mails to authorise payroll transactions; appropriate guidelines; and up-to-date schedules of delegations.

- **Control activities**
  - Generally, the perception has been that the payroll function has been well controlled. The audit highlighted that this perception is not well founded and scope remains for all organisations to improve and enhance their control activities. In larger organisations particularly, the payroll control activities have not been the subject of management focus because of this perception. This has resulted in a lack of enforcement of a number of controls particularly in relation to reconciliation procedures and security arrangements. Management focus on the enforcement of key controls would address a number of the deficiencies highlighted by the audit.

- **Information and communication**
  - The organisations subject to the audit have yet to fully explore and establish the benefits in maximising the management reports available to them. In addition, it was not always apparent how the reports produced were actually utilised. This could be addressed by the implementation of systematic payroll exception reporting which would allow organisations to address this utilisation issue.
  - Arrangements within the organisations were also generally deficient in respect of problem resolution procedures, the establishment of which would enhance payroll information and communication processes.
  - Overall, organisations have established appropriate processes to ensure financial information is appropriately reported in the annual financial statements which allows them to meet Government and legislative requirements.

- **Monitoring and review**
  - The audit highlighted that organisations underestimated the importance of monitoring and review as controls in themselves. Few organisations sought positive confirmation of payroll data from operational areas which would represent an independent organisational confirmation of data and help guard against erroneous payments.
  - The organisations that had outsourced their payroll functions were more advanced in their monitoring and review as the contract negotiation process and the nature of contract monitoring had focussed their attention on this area. Some of the other organisations with more traditional payroll models had generally not addressed quality control arrangements and reporting mechanisms, such as through the establishment of appropriate key performance indicators (KPIs).

13. Chapter 2 of this report provides further detail on these findings. The ANAO provided a report on the results of the audit to each organisation reviewed that included a number of specific recommendations relevant to those organisations. Each organisation responded positively to the recommendations made.

Sound and better practice identified

14. The audit process involved addressing the audit objectives and assessing payroll arrangements against five audit evaluation criteria. It also sought to identify instances of:

• sound business practice in place across APS organisations; and

• better practice in place in those organisations which reflect innovative payroll arrangements.

15. The audit identified examples of both sound business practices and better practice used by the organisations reviewed. While many of the sound business practices would be expected to exist in all organisations reviewed, this was not the case. Details of these approaches have been included in the Report to provide organisations with some insight into approaches being taken in other organisations in the APS.

Figure 1
Sound and better practice identified during the audit

Risk assessment	Fraud control plan includes consideration of outsourced arrangements
	Risk management policy and guidelines in place
	Information Technology security policy is in place
Control environment	There is a formal process to provide policy guidance for outsourced providers
	There is structured training for payroll staff
	High level of physical security is maintained for payroll data and files
	Procedural guidelines are in place for payroll staff
	A privacy policy is in place that addresses payroll data and files
Control activities	A centralised AWA unit was established, which promoted continuous improvement and provided an overall management/administrative role for AWAs
	The process and parameters of negotiating AWAs with staff, are addressed in AWA policies and guidelines
	An overpayments policy is in place and a register of overpayments maintained
Information and communication	Payroll policies and guidance are readily accessible on the organisation's Intranet
Monitoring and review	Key performance indicators have been established for the payroll function
	A committee structure is in place to oversee the service provided under outsourced arrangements
	Positive confirmation is obtained from budget holders of payroll details and expenditure
	The payroll function is subject to regular internal audit scrutiny
	Payroll details are regularly reviewed by operational divisions or budget holders

Better practice

Sound business practice

Recommendations

The following recommendations are made in response to the findings of the audit and reflect ANAO research into better practice in payroll management generally. The audit findings and the issues that lead to these recommendations are discussed in detail in the following relevant sections of Chapter 2 as shown below.

While the organisations selected for audit were not necessarily representative of all organisations' payroll management, the following recommendations are considered to have relevance to all Commonwealth organisations and would provide a useful basis for any management review of the payroll function.

Risk assessment

Recommendation No. 1 Para. 2.27

It is recommended that organisations:

- establish risk management frameworks and progress their application to address the process level risks associated with payroll arrangements;

- ensure that a fraud control plan is established which addresses payroll arrangements and is reviewed when payroll operations are outsourced or otherwise significantly change; and

- put in place IT security policies that cover their payroll and related systems.

Control environment

Recommendation No. 2 Para. 2.49

It is recommended that organisations:

- review and strengthen their payroll policy frameworks to ensure they address technological developments and privacy requirements;

- establish procedural guidelines for payroll processes;

- ensure up-to-date schedules of delegation are established and maintained; and

- adopt standard documentation across the organisation for payroll related processes.

Recommendation No. 3 Para. 2.50

It is recommended that organisations, within the context of a remuneration policy framework, establish appropriate policies and guidelines outlining their approach to entering into AWAs with employees.

Control activities

Recommendation No. 4 Para. 2.69

It is recommended that organisations review their processes to ensure reconciliations are conducted and reviewed in a timely manner.

Recommendation No. 5 Para. 2.70

It is recommended that organisations:

- strengthen and enforce the security arrangements for the protection of payroll files and data, including adherence with privacy requirements; and

- regularly review logical security access rights to ensure they remain current.

Information and communication

Recommendation No. 6 Para. 2.87

It is recommended that organisations review, on an ongoing basis, their management reporting to ensure it remains relevant, timely and appropriately utilised.

Monitoring and review

Recommendation No. 7 Para. 2.105

It is recommended that organisations ensure that their internal audit plans reflect an assessment of payroll risks and appropriate audit coverage of the payroll system.

Recommendation No. 8 Para. 2.106	It is recommended that organisations enhance their monitoring and review arrangements by: • strengthening the processes for establishing, monitoring and reviewing the quality of payroll service provision; and • establish appropriate performance targets and indicators.
Recommendation No. 9 Para. 2.107	It is recommended that organisations ensure that operational staff confirm the accuracy of payroll information when it is circulated.

Organisations' responses

16. Organisations generally agreed with the recommendations, with a number of organisations indicating remedial action had been initiated following the audit.

Audit Findings and Conclusions

1. Introduction

This chapter defines the payroll process and describes the organisations included in the audit. It also considers previous audit coverage, the scope and objectives of the current audit and the audit criteria used.

The payroll function

1.1 For the purposes of the audit, payroll management concerns all aspects of the arrangements that are in place to ensure that employees of an organisation receive remuneration which is in accordance with their terms of employment, is lawful and is appropriately recognised in the financial statements of the organisation.

1.2 Commonwealth organisations spent in excess of $15 billion on staff costs[5] in 1999–2000, which accounted for over 10 per cent of total annual Commonwealth expenditure.

1.3 The payroll activity includes all processes required to pay salaries and wages in accordance with organisation policies, including certified agreements and AWAs, and government regulations. A primary business objective of payroll management is to be an efficient and effective processor of employee salaries, wages, benefits and reimbursable expenses. For most organisations, payment of wages, salaries and related benefits is a linear process that begins with either the commencement of employment for an individual or advice of a variation to an existing entitlement, payment to the staff member and ends with the completion of the necessary reconciliations. The basic process is graphically represented at Figure 2.

1.4 The payroll activity is one of the more significant of the finance functions, accounting for a median 21.2 per cent of the total finance function operating costs and is the second most significant activity after budgeting. Payroll staff account for a median 23.81 per cent of the total finance function staffing[6].

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[5]   Consolidated Financial Statements of the Commonwealth, for the year ended 30 June 2000. Figures for 2000–2001 were not available at the time of the audit.

[6]   ANAO Audit Report No.25 2000–2001 *Benchmarking the Finance Function*, p. 71.

Figure 2
Payroll process
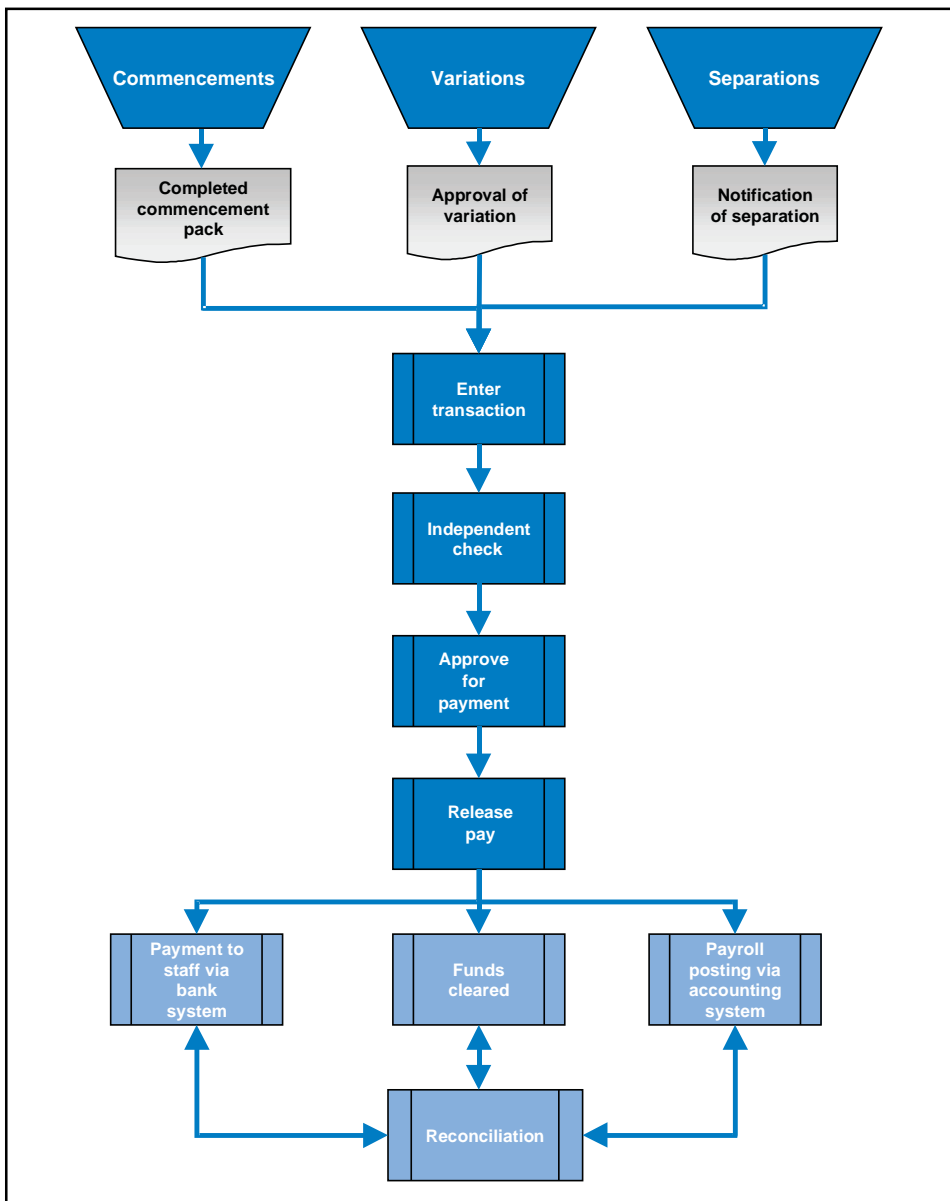
1.5 Payroll processes include:

- monitoring employee time and attendance;
- calculating gross and net pay;
- distributing net pay;
- disbursing withholdings or deductions from gross pay;
- maintaining and updating all payroll-related data;

- processing payroll accounting entries; and

- resolving payroll inquiries.

1.6   The inputs and outputs from the payroll process are represented in Figure 3.

Figure 3
Payroll inputs and outputs
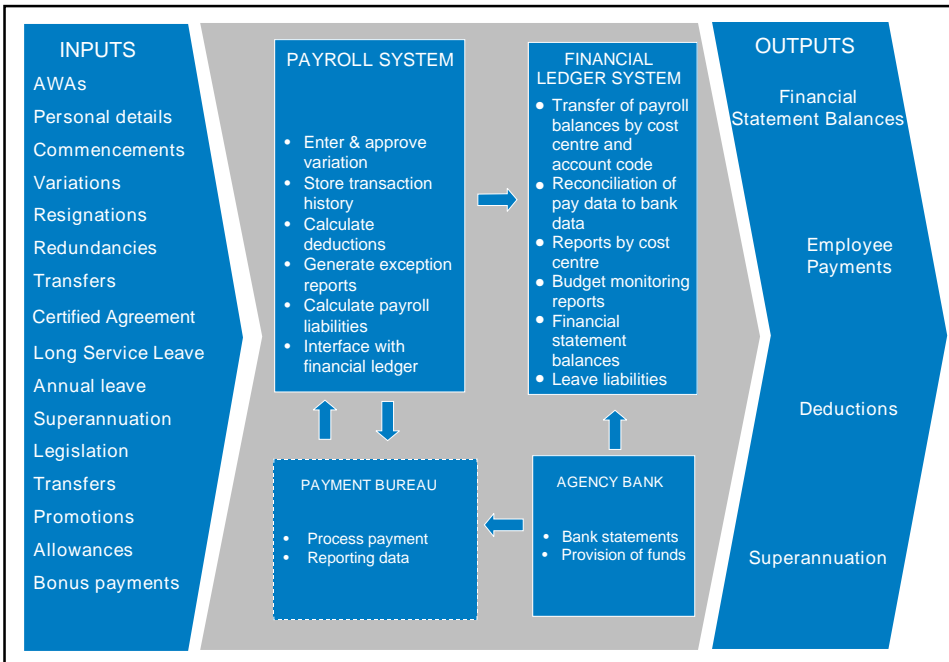
Current Commonwealth Operating Environment

1.7   The audit evaluated payroll management in a public sector environment that is undergoing continuous change. The traditional service delivery methods have been challenged and Commonwealth organisations have adopted new and varied approaches towards the provision of public services. In summary, the reforms and other changes faced by the APS included:

- **Workplace relations arrangements**—changing the workplace relations arrangements applying to the APS is a major element of the Government's ongoing APS reform;

- **Financial management reform**—the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997* introduced formal fiduciary responsibility at an organisation level;

- **Accrual budgeting**—this has resulted in additional financial management responsibilities being devolved to individual organisations from central agencies; and

- **Competitive tendering and contracting**—this has resulted in an increase in market testing, and outsourcing.

Further detail is in Appendix 4.

1.8   Public sector payroll arrangements have been impacted by these developments. This has led to an increased focus on whether payroll services should be delivered by an in-house payroll function or whether efficiencies and savings can be generated by moving to an external provider. The implementation of more sophisticated payroll and human resource IT systems has also prompted organisations to review their working methods and rely more on electronically held data. Organisations have invested significantly in new technology in order to provide the payroll service previously delivered centrally.

Previous audit coverage

Assurance audits

1.9   There has been limited external audit activity on payroll management in recent years other than that carried out as part of the audit of an organisation's financial statements.

1.10   Payroll management is generally considered relatively low risk for financial statement audit purposes, as most payroll errors are unlikely to result in material misstatement of an organisation's financial statements. Accordingly, analytical review is a common audit procedure in financial statement audits, particularly in relation to employee expenses.

1.11   The ANAO has previously reported[7] weaknesses in controls over attendance recording, termination payments and payroll. In relation to attendance recording, the audits found instances of inadequate review of attendance records and weaknesses in the operation of controls designed to ensure that attendance and leave forms were submitted and processed in a timely manner. In addition, the audits identified that the calculation of allowances was not always checked, resulting in incorrect payments being made and leave not always being deducted from officers' entitlements.

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[7]   ANAO Audit Report No.22 1997–98 *Audit of the Financial Statements of Commonwealth Entities for the Period Ended 30 June1997*, and ANAO Audit Report No.20 1998–1999 *Audit of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 1998*.

1.12   In reviewing termination payments, the financial statement audits identified control deficiencies in ensuring that the payments were accurate, resulting in a high error rate in the calculation of payments. The financial statement audits also reviewed whether payroll output reports were reconciled to the inputs processed. This reconciliation is a key control in the detection of unauthorised payments. These audits noted instances where the reconciliation had not been performed.

Performance audits

1.13   Related performance audit activity has included reports on staff reductions and certified agreements in the Australian Public Service[8].

This audit

Objectives

1.14   The main objectives of the audit were to:

- determine whether organisations have established effective internal control frameworks for the management of payroll operations;

- assess whether payment of salaries and related expenditures is made in accordance with the relevant terms and conditions of employment; and

- identify better practices in the management and operation of payroll systems.

Scope

1.15   The scope of the audit covered:

- identification of the range of payroll arrangements in place in the selected organisations, including outsourced payroll activities;

- terms and conditions of employment and associated personnel policies and procedures;

- the controls in place in respect of payroll systems, including elements which are currently undertaken by service providers under outsourcing arrangements;

- the processes and controls in place to ensure that payroll balances are accounted for correctly during the financial year and in the financial statements of the organisation; and

- the identification and application of better practice principles/ checklists, where appropriate.

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[8]   ANAO Audit Report No.49 1998–99 *Staff Reductions in the Australian Public Service* and ANAO Audit Report No.13 2000–2001 *Certified Agreements in the Australian Public Service.*

1.16   The audit has been confined to the systems associated with the payment of employee expenses (for example, salaries, allowances and deductions) and employee provisions (for example, annual and long service leave). It has not included payments to contractors.

Organisations reviewed

1.17   The audit involved six Commonwealth organisations of differing size, structure and nature. Two of the organisations were government departments, which report under the FMA Act and employ staff under the PS Act. The other organisations report under the CAC Act and employ staff under the PS Act or their own enabling legislation.

1.18   The smallest organisation employed 111 staff and the largest approximately 4500 staff. The payroll arrangements reviewed included:

- fully in-house payroll function;
- organisations with an in-house payroll function, but outsourced transaction payment arrangements;
- an organisation with an outsourced payroll function; and
- an organisation where both the payroll and human resource functions had been fully outsourced to an external supplier.

1.19   Detailed reports were issued to each of the organisations detailing the findings from the audit, highlighting better practice identified and making recommendations in relation to the findings from the audit.

Audit evaluation criteria

1.20   The audit findings and recommendations are organised in accordance with the framework detailed in the ANAO's 1997 *Better Practice Guide to Effective Control, Control Structures in the Commonwealth Public Sector: Controlling Performance and Outcomes* (ANAO *Better Practice Guide—Controlling Performance and Outcomes*). Summary detail is provided in Appendix 1, Table 6.

1.21   Audit criteria were developed against each component of the internal control framework[9] to assess the effectiveness of payroll management. Management is responsible for establishing a robust internal control framework with cohesive policies, processes and procedures that collectively ensure risks are well managed and business objectives are met in an effective, efficient and ethical manner. The quality

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[9]   The internal control framework consists of five elements: risk assessment; control environment; control activities; information and communication; and monitoring and review.

of the design of the controls has a direct relationship to the cost of the function. Properly designed controls will ensure risks are mitigated by an acceptable level of control, which is cost-effective.

1.22   The criteria have been adapted and expanded to take account of the diverse risks and operations of payroll management. Development of the criteria also considered better practices in both the business and government sectors' payroll management.

Structure of the remainder of the audit report

1.23   Chapter 2 outlines the detailed findings of the audit. The Appendices provide background to the audit observations and findings. They also consider the current context within which the organisations operate and their statutory framework, as well as global changes ranging from technological advances to risk management. Information in the Appendices also includes details of a payroll processing risk model and payroll better practice.

2. Audit Findings—Internal Control Framework

This chapter discusses the findings and recommendations of the audit against each component of the internal control framework.

Introduction

2.1   Central to the internal control framework is the understanding that control is a process, effected by the governing body of an organisation, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the organisation's objectives[10].

2.2   This framework relies on the five key control elements specified in the ANAO *Better Practice Guide—Controlling Performance and Outcomes*:

- risk assessment;
- control environment;
- control activities;
- information and communication; and
- monitoring and review.

2.3   This framework has been adapted to reflect key operational and risk aspects of organisations' payroll management.

Risk assessment

Introduction

2.4   The MAB/MIAC publication[11], *Guidelines for Managing Risk in the Australian Public Service,* defines risk as:

> *The exposure to the possibility of such things as economic or financial loss or gain, physical damage, injury or delay, as a consequence of pursuing a particular course of action. The concept of risk has two elements, ie. the likelihood of something happening and the consequences if it happens.*

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[10]   Based on COSO Internal Control—Integrated Framework as amended by NSW Treasury, *Statement of Best Practice, Internal Control and Internal Audit*, June 1995.

[11]   *Guidelines for Managing Risk in the Australian Public Service*, Management Advisory Board/ Management Improvement Advisory Committee (MAB/MIAC) Report No.22 October 1996.

2.5 As such, risk management is the process of systematically applying management policies, procedures and practices to the identification, analysis, assessment, treatment and monitoring of risk *(AS/NZS 4360:1995)*[12]. A sound risk assessment also provides the basis for ensuring responsibility for managing risks is properly distributed to managers who understand the risks and can be held accountable for their management through the operation of the control framework.

2.6 In implementing risk management, organisations should also be cognisant of the need to ensure that the cost does not outweigh its benefits. As noted in the MAB/MIAC publication[13]:

> *In managing risk you need to strike a balance between the cost of managing the risk and the benefits to be gained. Recognising that a risk-free environment is impossible (if not uneconomic) to achieve, you need to decide what level of risk is acceptable.*

2.7 The audit sought to establish, in general terms, the risk management framework within the organisations and specifically how this had been applied to the organisations' payroll arrangements.

2.8 Risk management in respect of payroll operations would be expected to generally form part of the human resource or financial services risk assessment and plan, under the organisation's overall risk management framework. It should also be linked to the organisation's fraud control policy and plan, IT strategy and IT security policies.

Benefits of risk assessment

2.9 The benefits to an organisation of implementing systematic and effective risk management include:

- an improved and better informed strategic planning and decision making process;
- the enhancement of corporate governance arrangements;
- the ability to demonstrate diligence and transparency; and
- the ability to implement timely action should risk scenarios arise.

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[12] *Australian/New Zealand Standard for Risk Management*, Standards Australia 1995.

[13] op. cit., *Guidelines for Managing Risk in the Australian Public Service*.

2.10 In relation to payroll arrangements the application of risk management principles, and specifically the organisation's risk management framework, should result in:

- a systematic approach to payroll management which identifies risk areas and an assessment of their likelihood and impact;

- payroll policies and procedures which address the risks identified and support action plans to address these risks;

- a reduction in crisis management; and

- a transparent link to the organisation's fraud control plan and IT security plans.

Audit findings and comment

2.11 The following table summarises the audit review of risk assessment.

Table 1

Risk assessment audit findings

Principle	Implementation of an effective risk assessment framework is a central element of managing the payroll function.
Audit evaluation criteria	The organisation would be expected to have undertaken a risk assessment of its business operations including personnel management considerations. Furthermore, the organisation would need to have assessed the risks involved with payroll processing, eg. overpayments, fraud. The organisation's fraud control plan may be the appropriate document in the absence of a risk management plan covering payroll.
Audit findings	In relation to the six organisations reviewed, the audit found that: • some did not have organisational risk management policies and plans in place; • none had applied process level risk management to the payroll function; and • some did not have finalised fraud control plans or an IT security policy in place.
Sound and better practice	The audit noted that one organisation had a fraud control plan in place that included a consideration of outsourced payroll arrangements.

Risk assessment and management

2.12 Overall risk management processes need to be improved in respect of payroll management and activities. The audit highlighted that the organisations reviewed were at varying stages in respect of establishing and implementing risk management frameworks. The audit found that the focus was still primarily at an organisation level or on core business activities rather than the support processes, such as the payroll function.

2.13 In the organisations where a corporate framework for risk management had been established, this had yet to be applied to the payroll function. This generally meant that payroll risks had only been considered in the context of fraud and the risk of IT system failure.

2.14 Organisations did not undertake process level risk assessments related to the payroll function because it was not considered to present a significant risk to the organisation in the context of its operating environment. In part, this perception was based on a lack of knowledge of a process level risk assessment and the benefits it can provide.

2.15 A process level risk assessment and the development of controls to manage the identified risks, provides the basis for an effective and efficient payroll function. A process level risk assessment can enhance control structures, detect control weaknesses, prevent control breakdown, increase operational efficiency, and improve performance. Importantly, it may also confirm organisational perceptions that the payroll function is low risk and operating effectively and efficiently. While all organisations demonstrated concern related to the efficiency and effectiveness of the payroll control framework, the ANAO found few circumstances where the design of controls had been adapted to take account of process level risks. As a result, opportunities to identify gaps in the control framework or possible efficiencies in processes had not been identified.

2.16 The audit found that inadequate process level risk assessment had led to control weaknesses in the design of organisations' payroll control framework. Risks, including efficiency risk and lack of sufficient information for decision-making, had not been adequately mitigated. While the organisational risk assessment provides management with the necessary knowledge and understanding to manage risk, further development of risk assessment activity related specifically to the payroll process is required to fully understand control requirements. A more complete understanding of risk leads to, and encourages, a more complete understanding of control issues.

2.17 In general, if organisations had completed a structured process risk assessment and evaluated the related controls, many of the control weaknesses described in this Report could have been detected, sourced and resolved. For example, if organisations had formally assessed and then controlled the risk that processes were not efficient, it would have become evident that changes to the structural framework and use of relevant technology were required.

2.18 On the other hand, it was noted that where the payroll function has been outsourced, under a formal tender and contract arrangement, an assessment of risk (including process level risks) had formed part of the tender and contract process.

Fraud control

2.19 The risk of the occurrence of fraud within the payroll function should form part of an organisation's fraud control plan and should be linked to the organisation's risk management framework. The Commonwealth Fraud Control Policy[14] requires an organisation's fraud control plan to:

> *…contain procedures for implementing the Government's requirements in relation to fraud prevention, its detection, investigation and prosecution, and recovery and civil rights/privacy processes.*

2.20 This policy applies to all organisations that come within the scope of the FMA Act and those entities within the scope of the CAC Act which are budget funded for their operating costs.

2.21 While organisations displayed an awareness of the areas where fraud could occur within a payroll function, two of the larger organisations reviewed had not established fraud control plans. All of the fraud control plans in place included an assessment of payroll arrangements, although the risk rating varied due to the specific circumstances of the organisation[15].

2.22 Improvements are also required in ensuring that fraud control plans recognise the impact that outsourcing services can have on the organisation's fraud risk assessment and fraud prevention arrangements. This would ensure that the organisation appropriately considers the transfer of fraud prevention to the outsource provider, and clarifies where the risk of fraud lies and the responsibilities of the outsource provider in respect of fraud arrangements.

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[14] Commonwealth Law Enforcement Board 1994 *Best Practice for Fraud Control—Fraud Control Policy of the Commonwealth*.

[15] The ANAO has undertaken a series of audits of agencies' fraud control plans, including: Audit Report No. 45 2000–2001 *Management of Fraud Control*; Audit Report No.22 2000–2001 *Fraud Control in Defence*; Audit Report No.16 2000–2001 *Australian Taxation Office Internal Fraud Control Arrangements*; Audit Report No.6 2000–2001 *Fraud Control Arrangements in the Department of Health and Aged Care*; Audit Report No.5 2000–2001 *Fraud Control Arrangements in the Department of Industry, Science and Resources*; Audit Report No.47 1999–2000 *Survey of Fraud Control Arrangements in APS Agencies*; and Audit Report No.4 1999–2000 *Fraud Control Arrangements in Employment, Education, Training and Youth Affairs*.

Information technology security policies

2.23   The Year 2000 compliance issue focussed organisations on the importance of establishing business recovery plans[16]. More recently the prevalence of Internet viruses has highlighted the need for organisations to continue to address and enhance IT security and protection arrangements[17]. The audit found that some organisations had not established security policies and procedures. It is noted, however, that the organisations that had not established IT security policies recognised their importance and had set in train the drafting of these policies.

2.24   Over recent years the ANAO has published a number of reports that highlighted the importance of agencies establishing IT security policies and procedures[18].

Summary and conclusion

2.25   Overall, the audit found that organisations had focussed on establishing organisational or strategic risk frameworks. However, this approach had not been adopted or applied at a process level. This is particularly the case in relation to the payroll function, as it is perceived to be well established and routine in nature with adequate controls in place, and therefore low risk. These perceptions, however, have not been based on regular, informed assessments of the risks to the payroll function. Organisations had not adequately recognised and addressed the heightened risk profile resulting from the changes within the APS that have impacted specifically on payroll management and related arrangements.

2.26   The audit highlighted that there remains significant room for improvement in the application of risk management to payroll arrangements. To date, any consideration of payroll related risk has only related to fraud or IT issues. Undertaking a systematic process level risk assessment would allow organisations to address these deficiencies or gaps in their overall risk management framework and ensure that operational staff understand and apply the principles and better practice of risk awareness, assessment and management. It would also ensure that organisations had considered all of the potential risk areas.

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[16]   The ANAO published a Better Practice Guide on *Business Continuity Management, Keeping the wheels in motion*, January 2000. In addition, the ANAO published Audit Report No.27 1997–1998 *Managing the Year 2000 Problem* and Audit Report No. 22 1998–1999 *Getting over the Line*, which addressed Year 2000 issues.

[17]   The ANAO published a Better Practice Guide on *Internet Delivery Decisions, A Government Program Manager's Guide* in April 2001.

[18]   For example refer to ANAO Audit Report No.1 2001–2002 *Control Structures as part of the Audits of the Financial Statements of Major Commonwealth Entities for the Year Ended 30 June 2001*, Chapter 4.

Recommendation No.1

2.27 It is recommended that organisations:

- establish risk management frameworks and progress their application to address the process level risks associated with payroll arrangements;

- ensure that a fraud control plan is established which addresses payroll arrangements and is reviewed when payroll operations are outsourced or otherwise significantly change; and

- put in place IT security policies that cover their payroll and related systems.

Implementing the recommendation

2.28 The application of risk assessment and management principles to payroll would be expected to incorporate fraud and IT security issues, but not to be solely comprised of these elements. In applying risk management, organisations should also consider risks related to other areas such as staff turnover, succession planning and the loss of expertise and corporate knowledge, decentralised arrangements, non-compliance with legislation and taxation requirements and any consideration of payroll outsourcing arrangements.

2.29 Organisations would not be expected to undertake a risk assessment and apply risk management techniques to payroll in isolation, but rather incorporate it in the risk arrangements for the operational area under which payroll falls, such as human resources.

2.30 Appendix 2 details the process of addressing risk management in respect of payroll management. It gives examples of the risks to payroll management and what could happen where the risks are not effectively assessed and addressed.

Control environment

Introduction

2.31 A control environment is the organisational context that reflects management's commitment and attitude to the implementation and maintenance of an effective control structure[19].

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[19] op. cit., ANAO Better Practice Guide—*Controlling Performance and Outcomes.*

2.32   For an organisation to have an effective control environment it needs to be able to demonstrate this commitment at management level. This commitment can be demonstrated by having:

- documented payroll policies and procedures;

- a schedule of delegation or a delegations manual which clearly sets out areas of responsibility and authority;

- a structured training program for payroll staff; and

- payroll transactions fully documented.

Benefits of a robust control environment

2.33   The benefits of a control environment are based on:

- defined policies and procedures that clearly articulate business risks;

- consistent practice and application of policies and procedures; and

- a prescribed operational framework that optimises outputs and balances risks.

2.34   In a payroll environment, the transaction-based focus of activity demands a control framework which underpins the complete and accurate processing of all payroll related transactions.

Audit findings and comment

2.35   The following table summarises the audit review of the control environment.

Table 2

Control environment findings

Principle	The establishment of a control framework for payroll processes and transactions that addresses areas of responsibility, policy and procedures and training.
Audit evaluation criteria	The organisation would be expected to have: • issued policy regarding the objectives and processes of payroll operations; • determined responsibilities for managing the payroll function; • developed procedures for policy implementation and treatment of the associated risks; and • arranged for the training of relevant staff.
Audit findings	In relation to the organisations reviewed, the audit found that : • some did not have up-to-date schedules of delegations; • most organisations did not have procedural instructions in place for payroll staff; • some organisations had not established standard payroll processing forms across payroll and local offices; • some organisations needed to improve their level of training for payroll staff; • most organisations did not have policies and procedures outlining the approach to be taken to the management of AWAs; and • policy arrangements in relation to authorisation via e-mail had not been established.
Sound and better practice	The audit noted that: • one organisation had established a comprehensive formal process to provide policy guidance for the provider of the outsourced payroll function. • one organisation had established a centralised AWA unit, which promoted continuous improvement and provided an overall management/administrative role for AWAs; and • AWA policies and guidelines in one organisation addressed the process and parameters for negotiating AWAs.

Policies and procedures

2.36   Commonwealth organisations have an established history of structured remuneration policies and, as such, the existence of payroll policy frameworks was to be expected. The organisations reviewed had all established fairly comprehensive policy frameworks that addressed payroll operations, as reflected at Figure 4. One exception was noted in respect of the omission of a privacy policy at one of the larger organisations.

Figure 4
Payroll policies
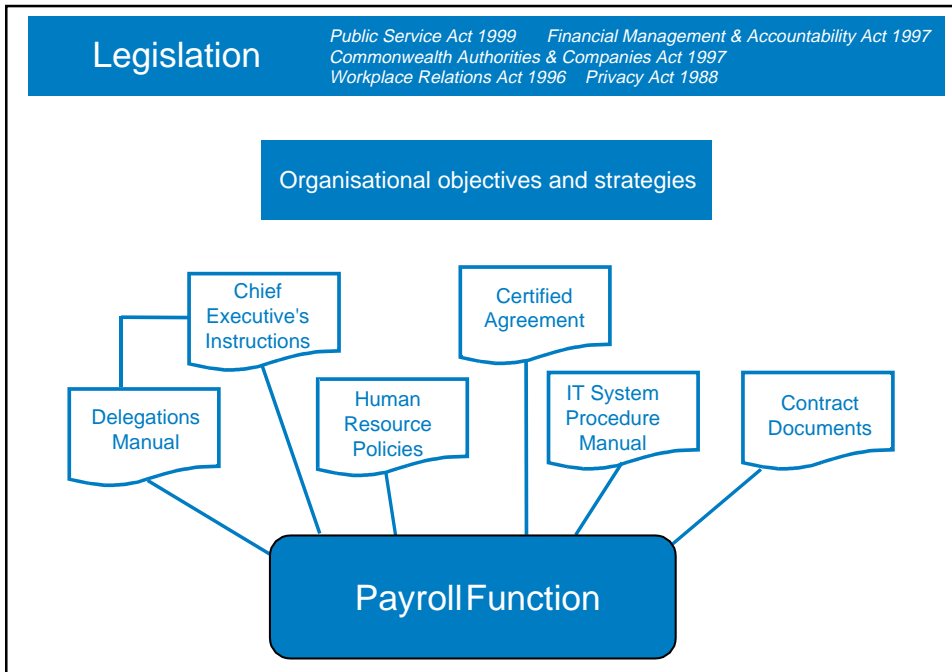
2.37 The audit found that, increasingly, e-mails were being used to authorise payroll transactions. However, organisations had not established policies and procedures for the appropriate use of e-mails as authority to process payroll transactions. As the level of acceptance of e-mails as sufficient authorisation to process payroll transactions increases, organisational risk also increases. The use of e-mails can expose an organisation to the risk of erroneous payments, particularly where the organisation is geographically spread or controls over personal computer terminals, such as password activated screensavers, are not in place. The ANAO considers that organisations should establish policies and procedures for the use of e-mails to authorise payroll transactions.

2.38 Further development in respect of the establishment of procedural guidelines for staff is also required. The majority of organisations reviewed did not have these in place and continue to rely on the experience of established payroll staff to be aware of correct procedures and provide on-the-job training to new staff.

2.39 Procedural guidelines would be expected to direct payroll staff to relevant documentation and policies, and specify acceptable and unacceptable practices. They also help to ensure that bad practices are not perpetuated by on-the-job training and where there is a high turnover of staff within the payroll function. The guidelines should aim to support the payroll process rather than be unnecessarily prescriptive.

Schedules of delegation

2.40   While all of the organisations had schedules of delegation in place, two were found to be out-of-date, one significantly. This suggests that the importance of maintaining current schedules of delegation needs to be reiterated and reinforced within the organisation to demonstrate good corporate governance arrangements.

Payroll documentation

2.41   Organisations have generally adopted standard documentation to expedite payroll processing. This consisted primarily of forms that required appropriate authorisation. Organisations, however, should guard against the practice of using locally developed forms as this practice can reinforce inconsistent payroll procedures and can result in inappropriate information being included on the forms. The audit identified examples of this in two organisations, one of which did not have a fully centralised payroll function.

Training

2.42   The audit found that training arrangements differed considerably between the organisations reviewed. The training of payroll staff is influenced by a number of factors including cost, the experience of payroll staff and the general stability of the function, the size of the organisation, the organisation's commitment to training and any outsourced arrangements.

2.43   Payroll training was generally provided by external organisations, one of which was used by most of the organisations reviewed. This was generally in recognition of the need to draw on expertise that was not readily available within the organisation. The external training was also supplemented by regular information from other sources, particularly the Australian Taxation Office.

AWAs

2.44   Organisations primarily employ and remunerate staff under frameworks that include certified agreements and legislation such as the PS Act. Under the *Workplace Relations Act 1996* employees are able to negotiate a more flexible remuneration package including through an AWA.

2.45   The audit did not identify any AWAs that had been inappropriately established. However, the audit found that the majority of organisations did not have specific policies or guidelines in place to cover the way in which AWAs should be established. Within the framework of an overall

remuneration policy, these policies and guidelines would be expected to cover:

- guidance on who should enter into AWAs with employees;
- parameters for the agreements;
- acceptable remuneration levels; and
- the approval, authorisation and lodgement process.

2.46 The audit found that organisations generally only had AWAs in place in respect of Senior Executive Service officers.

Summary and conclusion

2.47 The audit highlighted that controls in place generally centred on the more traditional areas, such as schedules of delegation, but were deficient in addressing changes in working and control processes prompted particularly by IT advances. Overall, the robustness of the control environments varied across the organisations although most met what would be considered minimum standards.

2.48 The audit also highlighted that improvements could be made to: policies and procedures relating to areas such as the use of e-mails to authorise payroll transactions; appropriate guidelines; and up-to-date schedules of delegations. This would be achieved through periodic review, close management consideration and the provision of appropriate training for staff.

Recommendation No.2

2.49 It is recommended that organisations:

- review and strengthen their payroll policy frameworks to ensure they address technological developments and privacy requirements;
- establish procedural guidelines for payroll processes;
- ensure up-to-date schedules of delegation are established and maintained; and
- adopt standard documentation across the organisation for payroll related processes.

Recommendation No.3

2.50 It is recommended that organisations, within the context of a remuneration policy framework, establish appropriate policies and guidelines outlining their approach to entering into AWAs with employees.

Implementing the recommendations

2.51 Organisational schedules of delegation, which incorporate payroll, could be subject to periodic review by the organisation's audit committee to help ensure that they are kept up to date and comply with good governance practices.

2.52 The establishment of procedural guidelines may be in written or electronic format, but organisations should ensure they support payroll processes and provide practical guidance for staff.

Control activities

Introduction

2.53 Control activities are the practices, processes and methodologies that assist an organisation in ensuring that:

- risks are reduced;
- irregularities are prevented or detected and addressed;
- assets are safeguarded; and
- financial records and relevant data are complete and accurately reflect the activities of the organisation.

2.54 Control activities should be prevalent within payroll processing procedures and incorporate authorisation and verification procedures, segregation of duties, system access controls and physical security arrangements.

Benefits of effective control activities

2.55 An effective framework includes both preventative and detective controls that minimise the impact of risks and contribute to the efficient and effective delivery of quality program outcomes. Control activities also help to ensure integrity, accuracy and completeness of the payroll function. Properly designed control activities provide an important key to efficiency in processing.

2.56 It is only at this level of the overall control framework that specific internal controls operate. The latter's effectiveness is greatly enhanced by the surrounding pervasive controls, the control environment, and monitoring and reporting activities. However, their failure can create wide-ranging risks, including exposure to fraud. For this reason, emphasis should be more on preventative rather than detective controls.

2.57 Effective control activities help ensure that processes are in place to protect the accuracy, completeness and existence of payroll data and guard against incorrect, misstated or erroneous transactions.

Audit findings and comment

2.58   The following table summarises the audit review of control activities.

Table 3

Control activities findings

Principle	The establishment of specific control mechanisms within payroll processes and significant payroll related transactions.
Audit evaluation criteria	The organisation would be expected to have specific controls for appointing new employees, calculating payments, authorising pay variations, approving termination payments, recording attendance and leave, recovery of advances and overpayments, reconciling payroll data, maintaining back-up records, and safeguarding personnel records.
Audit findings	In relation to the six organisations reviewed, the audit found that: • some organisations had inadequate arrangements in place to monitor and recover payroll overpayments; • most organisations needed to improve their review and evidencing procedures for bank and payroll reconciliations; • most organisations did not fully implement the required IT security controls; and • some organisations needed to revise their payroll IT system access structure and arrangements.

2.59   Commonwealth organisations have historically focussed attention on processing payroll transactions. This has been based on the control activities in place within payroll systems that generally occur during each payroll cycle and are embedded in the related processes. There was, therefore, an expectation in the audit of finding well-established control activities.

2.60   The audit highlighted that control activities were not always recognised or understood because they were hidden within the routine processes of the payroll function. This resulted in a lack of focus on their purpose and value. The audit identified specific lapses of control activities across the organisations which were more frequent in some of the larger ones reviewed. The main areas where issues with control activities were identified are detailed below.

Reconciliation arrangements

2.61   In the majority of organisations, appropriate payroll reconciliation controls had been established. However, the audit found that in most organisations evidence of independent review and authorisation of reconciliations was inadequate. The audit also found that one organisation did not have adequate reconciliation arrangements in place between the payroll, financial ledger and intermediate systems. The ANAO considers that scope exists for organisations to improve their reconciliation arrangements and processes.

Overpayments

2.62 The audit found that adequate overpayment records, including an overpayments register, were not maintained in some organisations. These records or registers facilitate the monitoring, control and quantification of salary overpayments and provide assurance that balances are being fully recovered on a timely basis. This record would also assist payroll management to identify any weaknesses in the payroll processing arrangements that lead to overpayments on a frequent basis. The ANAO also considers that organisational arrangements in relation to overpayments could be improved through the establishment of overpayment policies detailing repayment and authorisation requirements.

Authorisation and verification

2.63 The audit found that authorisation processes were in place at the organisations reviewed even though schedules of delegation were not always current. Isolated lapses of control were identified at some organisations, which highlights the importance of ensuring that control activities are enforced.

Segregation of duties

2.64 The audit found that all organisations were aware of the importance of ensuring that there was an adequate segregation of key payroll duties. Due to the limited size of the payroll function, smaller organisations tended to encounter problems ensuring that there was complete segregation of duties. The audit found that these organisations had established adequate compensating control activities to address the difficulties associated with their small size.

System access

2.65 The audit found that organisations had established logical access controls for their payroll IT systems that relied on user identifications and passwords. The audit did not identify any instances of inappropriate access to the IT systems, however, the system access profiles of two organisations were out of date. This resulted in access rights remaining active for payroll staff no longer employed at the organisation or organisation staff being able to gain access as a proxy for their supervisor to authorise payroll transactions.

Security arrangements

2.66 The audit found that the payroll functions operated in designated areas within the organisations and physical access was adequately controlled. There remains, however, scope for the improvement of

security arrangements across organisations particularly in respect of the activation of password-controlled screensavers when staff are away from their computers. It was also noted that the requirement to lock away payroll files overnight was not in place across most organisations. As a result, inappropriate access to payroll data was possible which increased the opportunity for personal information to be misplaced or misused.

Outsourced arrangements

2.67   The audit found that, generally, organisations that had outsourced their payroll functions had a greater awareness of the importance of ensuring effective control activities were in place and enforced.

Summary and conclusion

2.68   Generally, the perception has been that the payroll function has been well controlled. The audit highlighted that this perception is not well founded and scope remains for all organisations to improve and enhance their control activities. In larger organisations particularly, the payroll control activities have not been the subject of management focus because of this perception. This has resulted in a lack of enforcement of a number of controls particularly in relation to reconciliation procedures and security arrangements. Management focus on the enforcement of controls would address a number of the deficiencies highlighted by the audit.

Recommendation No.4

2.69   It is recommended that organisations review their processes to ensure reconciliations are conducted and reviewed in a timely manner.

Recommendation No.5

2.70   It is recommended that organisations:

• strengthen and enforce the security arrangements for the protection of payroll files and data, including adherence with privacy requirements; and

• regularly review logical security access rights to ensure they remain current.

Implementing the recommendations

2.71   Organisations should take a practical, risk-focussed approach to strengthening their control activities to ensure that they are effective and provide value to the payroll arrangements rather than just increasing the administrative workload. The purpose of the controls should be clear and able to be understood by payroll staff.

Information and communication

Introduction

2.72 An organisation's information and communication arrangements are fundamental to ensuring the achievement of organisational objectives. Effective arrangements provide a solid foundation for informed decision making and performance reporting. Information and communication arrangements will differ depending on the size, structure and geographical distribution of the organisation. The arrangements will also involve manual and computerised systems.

2.73 Information and communication in relation to payroll arrangements should incorporate the following:

- accurate and timely financial and management reporting;
- clear communication processes between the payroll function, or outsourced provider, and the rest of the organisation; and
- establishment of problem or complaints resolution procedures.

Benefits of effective information and communication

2.74 The benefits of effective information and communication include allowing the organisation to establish if resources are being applied appropriately, whether organisational goals are being achieved and if service delivery is economic, efficient and effective.

2.75 Performance reporting assists organisations to understand whether the payroll function is meeting the needs of the organisation. It contributes to continuous improvement and enables staff to undertake and monitor their own operational activities, which can further be used as a tool in building staff skills, confidence and morale.

Audit findings and comment

2.76 The following table summarises the audit review of information and communication.

Table 4

Information and communication findings

Principle	The establishment of effective communication and the transfer of information within the payroll function and between the payroll function and the organisation.
Audit evaluation criteria	The organisation would be expected to have systems for capturing and reporting payroll information, with close links between the general ledger and payroll management information system. The organisation would also be expected to have regular two-way information flows between the staff (or service bureau) responsible for payroll processing and those responsible for managing the activity and the personnel section and individual employees.
Audit findings	In relation to the six organisations reviewed, the audit found that: • most of the organisations had not established systematic exception reporting processes; and • some organisations did not have problem or complaint resolution procedures in place.
Sound and better practice	The audit noted that payroll policies and guidance are readily accessible on the organisation's Intranet.

Payroll reporting

2.77 The audit identified that organisations generally have adequate processes in place to ensure that the financial payroll information included in the annual financial statements is appropriate. This is, however, reliant on adequate reconciliation, verification and authorisation controls.

2.78 The sophistication of the payroll IT systems in place also allows organisations to produce a range of payroll reports on a regular basis for management scrutiny. However, the quality of the reports and the extent of their use varied between the organisations reviewed. The audit highlighted that scope remains to improve the quality and timeliness of management information, particularly where upgrades to the payroll IT systems allow for greater functionality. The action taken in respect of these reports should also be more transparent to ensure that the reports generated are also utilised or, if not, assess whether they are still required.

Exception reporting

2.79 The audit identified that most of the organisations had not established systematic exception reporting. Exception reporting involves generating management reports from the payroll system to identify exceptional items such as payments over a specified value, changes to employee details, and staff starting or leaving the organisation. These reports enable a specific population from the payroll system to be identified and reviewed to ensure that it is accurate and reasonable.

Problem resolution

2.80 Scope exists for organisations to improve their payroll arrangements through the establishment of more formal problem resolution procedures and reporting mechanisms, which could also be incorporated in performance indicators. Payroll functions deal with queries from staff on a daily basis and while these issues appear to be addressed there is scope to improve the arrangements for recognising and reporting issues. The audit found that there was a lack of clarity as to when queries should be escalated and highlighted for management attention.

2.81 This is particularly important where the payroll processing function has been outsourced to ensure that the organisation is aware of staff queries and to provide information for the monitoring of the quality of service provision.

Communication

2.82 The audit highlighted that organisations make use of a range of mechanisms to maximise communication and access to payroll information. This includes management and financial reporting, e-mail communication and the organisation's Intranet, as well as through the telephone, written and face-to-face contact.

2.83 The audit observed sound arrangements in most of the organisations reviewed, however, one organisation needed to improve its communication between payroll offices to promote consistent practices.

Summary and conclusions

2.84 The organisations subject to the audit have yet to fully explore and establish the benefits in maximising the management reports available to them. In addition, it was not always apparent how the reports produced were actually utilised. This could be addressed by the implementation of systematic payroll exception reporting which would allow organisations to address this utilisation issue.

2.85 Arrangements within the organisations were also generally deficient in respect of problem resolution procedures, the establishment of which would enhance payroll information and communication processes.

2.86 Overall, organisations have established appropriate processes to ensure financial information is appropriately reported in annual financial statements which allows them to meet Government and legislative requirements.

Recommendation No. 6

2.87 It is recommended that organisations review, on an ongoing basis, their management reporting to ensure it remains relevant, timely and appropriately utilised.

Implementing the recommendation

2.88 Organisations should seek to maximise the functionality and reporting ability of their current IT systems in the establishment of routine exception reporting. It may be appropriate to consider software tools that can interrogate payroll data to extract the data required for exception reporting purposes.

Monitoring and review

Introduction

2.89 An effective organisational control structure should have robust monitoring and review processes in place which involve overseeing the operational objectives and control activities. Monitoring and review should be undertaken on an on-going basis and be built into the day-to-day activities of the system. It can, however, also be carried out as a separate activity on a periodic basis. The responsibility for carrying out monitoring and review should be clearly defined.

2.90 On an ongoing basis payroll transactions and processes should be monitored by payroll managers and supervisors. Payroll monitoring and review processes should also incorporate:

- internal and external audit scrutiny;
- budget monitoring of payroll balances;
- quality control processes;
- performance indicators; and
- independent review at divisional or budget holder level.

Benefits of effective payroll monitoring and review

2.91 Effective monitoring and review provides the organisation with assurance that payroll controls are operating, transactions are being appropriately processed and standards of service are being maintained. Periodic monitoring and review is often aligned with sharing ideas, both across the organisation and externally. In-built monitoring and review mechanisms, such as control self-assessment, encourages ownership of controls as well as enhancing the control structure.

Audit findings and comment

2.92 The following table summarises the audit review of monitoring and review.

Table 5

Monitoring and review findings

Principle	The implementation of a structured approach to the monitoring and review of payroll arrangements, processes and transactions.
Audit evaluation criteria	The organisation would be expected to have regular monitoring and review processes to ensure that policies and procedures are adhered to and properly applied, and to identify changes and weaknesses in the operating environment. This might be achieved by reporting against performance activities, the conduct of surveys, internal checking and auditing processes, and comparison with external organisational benchmarks. The results from the monitoring and review of the payroll process need to be fed back into the next planning/risk management cycle.
Audit findings	In relation to the six organisations reviewed, the audit found that: • some organisations did not include coverage of payroll risks in audit plans; • some organisations did not have focussed quality control arrangements in place for the payroll function; • most organisations had not established key performance indicators for the payroll function; • most organisations did not seek positive assurance from operational areas that payroll details were accurate on a periodic basis; and • some organisations with outsourced payroll functions have yet to undertake a cost-benefit analysis of the service since the function was outsourced.
Sound and better practice	The audit found that: • some organisations had performance indicators in place for the payroll function and processes; and • one organisation obtained positive assurance from budget holders of payroll details and expenditure.

Organisational audit arrangements

2.93 Most of the organisations reviewed had well-established internal audit arrangements in place that were overseen by the audit committee. One organisation did not have an internal audit function due to the size of the organisation although payroll transactions were considered annually as part of the ANAO's financial statement audit and an audit committee had been established.

2.94 The audit found that it was not always possible to confirm the extent of payroll work planned by internal audit and the assumptions or risk assessment on which this work was based. The quality and

transparency of internal audit strategic plans could be improved in respect of proposed audits of the payroll function. The plans should be based on an assessment of the control risks for the organisational systems and reflect this in the coverage and frequency of internal audit reviews.

Performance monitoring and quality control

2.95 Performance monitoring is a key element of effective monitoring and review processes. The audit found that formal and documented quality control arrangements were generally evident in those organisations which had outsourced its payroll function because, the process leading up to outsourcing required agencies to focus its attention on the control environment. The audit noted that these arrangements were set out in the contract documentation and generally involved operational and strategic committees comprised of organisation and service provider representatives. These committees were the primary forum for discussion and clarification of service delivery issues and quality.

2.96 Similarly, performance indicators were more likely to have been established in organisations where the payroll function had been outsourced, as the requirement for performance indicator information to be collated and reported to the organisation was formalised in the contract documents. It was noted that the performance indicators comprised both statistical information and key milestones. These included:

- the percentage of commencements and terminations processed within a specified number of days of the receipt of relevant paperwork;
- the percentage of pay variations processed within the current pay cycle that the paperwork is received;
- the percentage of redundancies processed within five days of cessation;
- the percentage of overpayments; and
- group certificates distributed within two weeks of receipt.

2.97 While agencies' consideration of the case for outsourcing was a positive stimulus for enhancing the control environment, this outcome can also be achieved by enhanced management attention to the payroll function.

2.98 In a number of organisations the performance indicators established initially had been, or were in the process of being, revised based on experiences in the early stages of the outsourced arrangement.

2.99 Those organisations that retained an in-house payroll function tended to have less formal quality control arrangements in place which relied on audit reports, payroll management representation on executive groups and the prevalence of queries and complaints. For the smaller organisations the lack of formal systems was not surprising as management was closer to the function. The audit found that the lack of structured quality control arrangements in the large organisations increased the risk that deficiencies in the services provided by the payroll function may not be appropriately identified and reported.

Budgetary control

2.100 The concepts and requirements of budgetary control are well understood by Commonwealth organisations and underpin their functions and service delivery considerations. The audit found that all of the organisations reviewed incorporated payroll costs in their budget monitoring process. In one organisation, however, the audit found that balances to reflect leave liabilities were not incorporated in monthly budget monitoring reports, therefore reducing the accuracy of the budget monitoring process.

Circularisation

2.101 A key control or method of verifying payroll details is to circulate payroll listings or information to departments or divisions on a periodic basis. As part of the budget process the audit found that reports are circulated to budget holders or divisional managers which contain payroll related data and were intended to ensure that only appropriate employees were listed under the relevant cost centre.

2.102 Only two of the organisations reviewed sought positive assurance from operational areas that payroll details were correct. In the main, assurance was based on information being queried if it was incorrect. While it may not be practical to obtain confirmation from all operational areas for each pay-run it should at least be sought from a sample on a periodic basis. This would also promote detailed review of the information at local level.

Summary and conclusion

2.103 The audit highlighted that organisations underestimated the importance of monitoring and review as controls in themselves. Few organisations sought positive confirmation of payroll data from operational areas which would represent an independent organisational confirmation of data and help guard against erroneous payments.

2.104 The organisations that had outsourced their payroll functions were more advanced in their monitoring and review as the contract

negotiation process and the nature of contract monitoring had focussed their attention on this area. Some of the other organisations with more traditional payroll models had generally not addressed quality control arrangements and reporting mechanisms, such as through the establishment of appropriate key performance indicators.

Recommendation No.7

2.105 It is recommended that organisations ensure that their internal audit plans reflect an assessment of payroll risks and appropriate audit coverage of the payroll system.

Recommendation No.8

2.106 It is recommended that organisations enhance their monitoring and review arrangements by:

- strengthening the processes for establishing, monitoring and reviewing the quality of payroll service provision; and

- establishing appropriate performance targets and indicators.

Recommendation No.9

2.107 It is recommended that organisations ensure that operational staff confirm the accuracy of payroll information when it is circulated.

Implementing the recommendations

2.108 Monitoring and review is a central part of an organisation's continuous improvement processes. On-going monitoring tends to be more effective than separate ad hoc evaluations. On-going monitoring can be achieved through traditional management and supervisory activity, and by encouraging staff to identify breakdowns, redundancies, duplications and gaps in control procedures.

2.109 Separate evaluations, such as internal audit reviews or process reviews, undertaken from time to time are also a useful monitoring and review tool. They take a fresh look at the effectiveness of control structures and often provide the opportunity for on-going monitoring procedures to be revisited.

2.110 The scope and frequency of monitoring and review activities will depend primarily on an assessment of risks and the effectiveness of on-going monitoring. The more on-going monitoring, the less need for separate evaluations. Importantly too, the effectiveness and appropriateness of the control structure can change as the environment changes. These can be wide-reaching and can range from, for example, changes in available technology, in systems and in organisational structure.

2.111 While the governing body of an organisation is responsible for the control framework, individual senior and line managers can facilitate operational improvement through taking personal responsibility. The ANAO has identified control self-assessment (CSA) as a better practice in monitoring and review activity[20]. CSA is the reporting process where managers are actually responsible for developing, assessing, maintaining and monitoring controls in their respective areas. This usually involves the completion of self-assessment checklists to confirm that control processes and procedures are clearly understood, implemented and are operating effectively. The checklist data can be collated along with other financial and operational performance data into reports, graphs and charts that measure actual performance against expectations.

Canberra ACT   P.J. Barrett
15 November 2001   Auditor-General

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[20] ibid., ANAO Better Practice Guide—*Controlling Performance and Outcomes.*

Appendices

Appendix 1

About the audit

Assurance and Control Assessment Audits

Assurance and Control Assessment (ACA) audits are undertaken under the general performance audit provisions of the *Auditor-General Act 1997*. They examine the internal control structures supporting common business support activities and processes that are not specifically covered by financial statement or other performance audits. Audit evaluation criteria are based on the five interrelated components of the control structure; namely:

- risk assessment;
- control environment;
- control activities;
- information and communication; and,
- monitoring and review.

Audit evaluation criteria

Table 6 shows the audit evaluation criteria mapped against the components of the internal control framework. Each organisation's management of the payroll function was assessed against these criteria.

Performance Information

Planning for this audit commenced in November 2000 with research into payroll management practices and private industry experience.

The elapsed time from the commencement of the audit to tabling this Report was twelve months and the total cost was $430 000. The audit was undertaken for the ANAO by KPMG on a contract-managed basis.

Table 6
Audit evaluation criteria

Criteria	Expectation
Risk assessment	The organisation would be expected to have undertaken a risk assessment of its business operations including personnel management considerations. Furthermore, the organisation would need to have assessed the risks involved with payroll processing, eg. overpayments, fraud. The organisation's fraud control plan may be the appropriate document in the absence of a risk management plan covering payroll.
Control environment	The organisation would be expected to have: • issued policy regarding the objectives and processes of payroll operations; • determined responsibilities for managing the payroll function; • developed procedures for policy implementation and treatment of the associated risks; and • arranged for the training of relevant staff.
Control activities	The organisation would be expected to have specific controls for appointing new employees, calculating payments, authorising pay variations, approving termination payments, recording attendance and leave, recovery of advances and overpayments, reconciling payroll data, maintaining back-up records, and safeguarding personnel records.
Information and communication	The organisation would be expected to have systems for capturing and reporting payroll information, with close links between the general ledger and payroll management information system. The organisation would be expected to have regular two-way information flows between the staff (or service bureau) responsible for payroll processing and those responsible for managing the activity and the personnel section and individual employees.
Monitoring and review	The organisation would be expected to have regular monitoring and review processes to ensure that policies and procedures are adhered to and properly applied, and to identify changes and weaknesses in the operating environment. This might be achieved by reporting against performance activities, the conduct of surveys, internal checking and auditing processes, and comparison with external organisational benchmarks. The results from the monitoring and review of the payroll process need to be fed back into the next planning/risk management cycle.

Appendix 2

Risk assessment

The figure and table below detail the process of addressing risk management in respect of payroll. The table gives examples of risk areas and some examples of what can happen where a risk is not appropriately assessed and addressed.
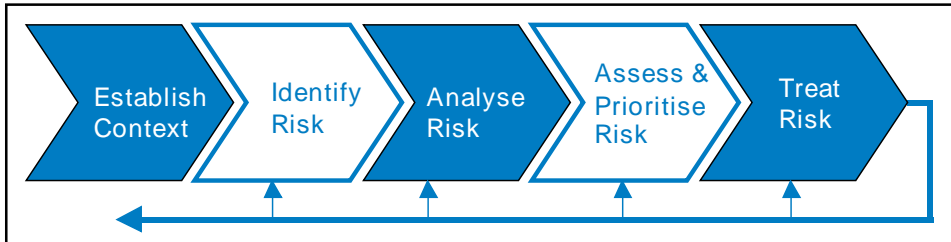
Figure 5

Risk management process

Table 7

Examples of risk areas and possible consequences

Payroll Process Risk	What does this mean?	Possible consequences
Operations Risks		
Human Resource Risk	The personnel responsible for managing and controlling the process do not possess the requisite knowledge, skills or experience to ensure that critical business objectives are achieved and significant business risks are reduced to an acceptable level.	• Staff are not adequately skilled to fulfil the functions required which may result in errors and over/ underpayments.
Efficiency Risk	The resources used to produce outputs are not minimised or the outputs produced from a given level of resources are not maximised.	• Payroll administration costs are increased.
Capacity Risk	The effective productive capacity of the process is not fully utilised.	• More payroll staff may be in place than necessary. • Over reliance on manual processing.
Cycle Time Risk	Elapsed time between start and completion of a payroll process (or activity within that process) is too long because of redundant, unnecessary and irrelevant steps.	• Delays in processing payments particularly non-routine payments.
Compliance Risk	As a result of flaw in design or operation, or due to human error, oversight or indifference, the payroll processes do not comply with prescribed procedures and policies. This results in lower quality, higher costs and unnecessary delays. It also gives rise to service failure because if not detected, the process can fail.	• Incorrect payments that do not comply with legislation, AWAs or the Certified Agreement. • Overpayments. • Failure to pay employees.
Business Interruption Risk	The risk that the failure of the payroll process would result in difficulty to continue operations.	• Can be a result of accidents, weather, work stoppages and sabotage, and results in dissatisfaction of those relying on the process.

Payroll Process Risk	What does this mean?	Possible consequences
Financial Risk		
Loss and reporting risk	The risk that payroll funds or balances are lost or incorrectly reported to improve organisational results.	• Incorrect financial statements through manipulation of leave balances. • Increased costs to the organisation through resources required to detect and correct balances and financial information.
Empowerment Risk		
Leadership Risk	Leadership is essential to successful payroll risk management, change management, and continuous business process improvement.	• Payroll processes that are unresponsive to changing requirements and ineffective in meeting the needs of the service 'clients'. • No clear sense of direction or motivation of payroll staff to improve efficiency. • Incorrect payments or misreported balances resulting from controls not being enforced.
Authority Risk	The risk that people either do things they are not supposed to do or fail to do things they should do.	• Unauthorised transactions or payments. • Unclear areas of responsibility within the payroll function. • Lack of management understanding about who is doing what, how often and why. • Managers and employees are given responsibilities that are inconsistent with the payroll objectives, strategy and prudent business risk management practice. • Payroll managers and employees do not believe they are empowered to act. Action is not taken on a timely basis resulting in adverse publicity, incorrect payments, retrospective adjustments and increased costs.
Limit Risk	Managers and employees exceed the boundaries of their empowerment or authorities.	• Erroneous or incorrect payments. • Unlawful deductions or payments.

Payroll Process Risk	What does this mean?	Possible consequences
Performance Incentives Risk	Managers and employees are monitored with performance activities that create incentives to act in a manner that is inconsistent with the company's business objectives, strategies and ethics.	• Performance measures that are unrealistic, difficult to understand or not objectively determined which fail to motivate staff and result in processing delays.
Communications Risk	Communications vertically or horizontally within the payroll function and the organisation are ineffective and result in messages that are inconsistent with authorised responsibilities or established measures.	• Senior management are not aware of payroll problems, which can delay action. • Inconsistent payroll practices, incorrect payments, employee dissatisfaction.
Information Processing/ Integrity Risk		
Access Risk	The risk that access to payroll information (data or programs) will be inappropriately granted or refused. Focus on the risk of inappropriate access to systems, data or information.	• Inappropriate people may be able to access confidential information resulting in failure to comply with legislative requirements. • Appropriate personnel may be denied access resulting in delayed payments. • Improper segregation resulting in erroneous payments. • Payroll payments are not approved by an appropriate officer. • Inappropriate access to organisation's network and corruption of files and data. • Out of date access rights to payroll system.
Relevance Risk	Risk that the payroll information is not relevant to the purposes for which it is collected, maintained or distributed. Relates to the useability and timeliness of information that is either created or summarised by an application system.	• Lack of compliance with privacy and tax legislation, resulting in fines or penalties. • Decisions are based on inadequate or inaccurate management information which can adversely impact on the services provided by the organisation or increase costs.

Payroll Process Risk	What does this mean?	Possible consequences
Integrity Risk	*Information Systems Infrastructure Management Process Integrity* Lack of effective and well-controlled business process in information systems, infrastructure management and process integrity are usually the root cause of access, relevance, and availability risks and application systems process integrity risks. *Application System Process Integrity* Encompasses the risks associated with authorisation, completeness, and accuracy of payroll transactions as they are entered into, flow through, are summarised by and are reported on by the payroll and related application systems.	• IT system development and maintenance may not meet user needs, processing delays, incorrect payments or higher costs. • Internal security that does not meet management policies or protect the payroll information and data. • Corruption of data. • Misstated payroll expenditure in management reports and the financial statements. Integrity can be lost due to: • programming, processing or management errors that result in data corruption and incorrect payments, which are complex to identify and correct; • amendments to rates of pay, deductions and other standing data are not properly authorised; • payroll payments are not made to the proper employee or other recipient; and • new employees are not placed on the payroll with authorisation and correct details.
Availability Risk	The risk that information will not be available when needed.	• Loss of communications, loss of basic processing capability and operating facilities.
Integrity Risk		
Employee Fraud Risk	Employees and customers, individually or in collusion, perpetrate fraud against the company, resulting in financial loss or unauthorised use of physical, financial or information assets. Potential for legal exposure, negative publicity and an adverse impact on operations.	• Changes to employee details are not authorised and entered accurately. • Necessary supporting documentation is not filed and kept in the appropriate place. • Staff terminations are not reflected in the payroll calculations, and all necessary entitlements are calculated correctly.

Payroll Process Risk	What does this mean?	Possible consequences
Illegal Acts Risk	Managers and employees individually or in collusion commit illegal acts.	• Increased costs, possible fines and damage to reputation.
Unauthorised Use Risk	The organisations physical and financial assets are used for unauthorised or unethical purposes by employees or others.	• This can result in loss of assets, increased costs, erroneous payments, overpayments, underpayments, adverse publicity and Government sanctions.
Reputation Risk	The risk that the organisation may lose status, key employees, attract adverse publicity or Government sanction due to its inability to: • deal fairly with stakeholders; or • know how to manage its business or services.	• Loss of employees means the loss of the talent, skills and expertise required, particularly for complex transactions, such as redundancy payments. • Loss of ability to operate process.

Appendix 3

Better practice

The following list is indicative of better practice initiatives in payroll management.

Objective	Better Practice
Risk management	• The risk management plan should be revisited on an annual/periodic basis and at the time of any major changes in the organisation's internal or external environments eg. the outsourcing of functions. • The risk assessment process should incorporate a protective security risk assessment for payroll data. • The risk assessment process should involve relevant human resources, payroll and finance staff. • The Fraud Control Plan should reflect any outsourcing arrangements and the associated impact.
Resource management	• Payroll staff should have ongoing training in legislative and policy requirements. • Succession planning should be established for payroll staff functions and responsibilities. • Arrangements should be in place so that access to HR experts can be readily obtained. • Rotation of staff in the payroll processing area for improved control and cross-skilling. • Organisations should establish specific groups with skills to negotiate AWAs.
Policies and guidelines	• Comprehensive policies and guidelines: —linking key controls and responsibilities; —written in plain English; —easily accessible; and —current. • Policies and guidelines to include an organisational privacy policy.
Control framework	• To include key controls with control duplication eliminated through the use of detective or compensating controls. • Conduct of control self-assessments by management. • Suite of exception reports to allow management to monitor and review with focus. • A HR Committee with responsibility for human resource (HR) policies including personnel management and development, and the driving of Certified Agreement processes. • Positive assurance of the accuracy of payroll reports by business areas on a sample basis. • Payroll reconciliations to be subject to independent review. • Periodic internal audit testing of payroll transactions. • Complaints resolution process to be defined and documented. • Emphasis on monitoring and review controls including exception reporting rather than input controls.

continued next page

Objective	Better Practice
Efficiency and effectiveness	• Cost-benefit of payroll function to be reviewed periodically. • Development of KPIs and measurement and monitoring of performance. • Feedback on the quality of payroll reports to be sought from clients periodically. • Benchmarking of the payroll function on a periodic basis. • Monthly payroll or four weekly payroll processing, as opposed to fortnightly payroll.
Technology improvement	• Implementation of fully integrated HR and finance systems. • Utilisation of e-mail notification for ad hoc payments. • Payslips provided through the web or e-mail subject to appropriate security arrangements being in place. • Employee self service systems for leave processing. • Electronic authorisation and lodgement of payroll forms complying with the *Electronic Transactions Act 1999.*

Appendix 4

Current Developments and Challenges

Introduction

The current operating environment of Commonwealth organisations is increasingly complex. This chapter describes the context of the audit through reference to the risks and opportunities within organisations in terms of both risks presented by the changing APS environment and by opportunities available through technology and commercial sector practice.

Workplace relations' arrangements[21]

Changing the workplace relations' arrangements governing the APS is a major element of the Government's ongoing APS reform agenda. These changes, together with reforms to financial and service delivery, were initiated by the Government to build a more highly performing APS and make it more responsive to the needs of the government and the community.

Two of the principal objectives of the workplace relations reforms in the APS were to:

- align workplace relations practice in the APS more closely with that applying in the broader public and private sectors, allowing the APS to become more competitive in a contestable environment and providing greater flexibility regarding pay and employment conditions; and

- establish more direct relationships between employers and employees at enterprise or workplace levels in determining wages and employment conditions. These were previously centralised and contained in a single enterprise agreement that covered all APS agencies.

The Government's aim was to develop a culture which fostered and rewarded high performance by encouraging APS agencies to negotiate wage outcomes and conditions at the workplace level that had the support of staff, that were linked to improved productivity and that were tailored to achieve organisational goals. The negotiation of certified agreements and Australian Workplace Agreements (AWAs) was the principal tool for achieving these aims.

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[21]   op. cit., ANAO Audit Report on *Certified Agreements in the Australian Public Service.*

Legislative and policy framework for agreement making in the APS

The *Workplace Relations Act 1996* (the Workplace Relations Act) provides the legislative framework in which to implement the Government's workplace relations reforms. Ultimately the outcomes sought by the Government in relation to APS employment were similar to those sought in the broader public and private sectors. The objective was for improved remuneration and working arrangements for staff to be linked to achieved improvements in the productive performance of each agency. In addition, the major aspects of the Government's workplace relations policy for Australian Government employment included:

- allowing freedom of association and securing appropriate rights of entry for union representatives;

- not limiting future agreement making options by making commitments in agreements which may inhibit how future agreements can be developed;

- providing, within certified agreements, for comprehensive AWAs to be made with staff; and

- developing comprehensive agreements as stand alone documents (at a minimum by displacing existing agreements, and wherever possible, awards). 'Stand alone' agreements provide for all the pay and conditions entitlements in one document thereby avoiding the complexities of having multiple instruments governing pay and employment conditions[22].

Workplace Relations Act 1996

The fundamental shift in the workplace relations framework, to a focus on individual workplaces, has underpinned the devolution of responsibility for workplace relations to the agency level. As a consequence, employment conditions are primarily determined through the certified agreement making process. Agencies can also develop AWAs with individual employees. The terms and conditions of employment are agreed at the workplace level so they can be tailored to suit the specific circumstances of the agency and its staff. This represented a significant change from past approaches under which the determination of standard pay, classifications and employment conditions had been centralised.

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[22] ibid., ANAO Audit Report on *Certified Agreements in the Australian Public Service*, p. 32.

Certified agreements

The Government's approach to agreement making required, *inter alia*, certified agreements to be:

- consistent with the Government's workplace relations policy and APS wages policy aimed at fostering more direct relations between employers and employees and with improvements in pay and conditions linked to productivity gains, thereby being consistent with maintaining low inflation;

- funded from within agency appropriations; and

- supported by accountability reporting against performance indicators that demonstrated performance improvements from their agreements (eg. in Annual Reports and reports to portfolio Ministers).

The Audit Report on *Certified Agreements in the Australian Public Service* concluded that overall agency certified agreements did identify a link between wage increases and productivity improvements, as required by the Government's Policy Parameters. However, most links were not explicit and involved a general reference only to the achievement of corporate goals, previous productivity gains and/or commitments to future potential productivity improvements. The majority of agencies did not make the payment of wage increases conditional on the actual achievement of improvements in productivity, nor did they develop and monitor outcome measures that related specifically to their particular agreement[23].

Public Service Act

The introduction of the Public Service Act in December 1999 represented the most recent step in the devolution of responsibility for setting employment terms and conditions to agency level and simplified the relationship between the Workplace Relations Act, the public sector employment framework and common law requirements.

The legislation is basically principles-based with APS employment governed by APS values and a code of conduct rather than by rules and prescription. The procedural details are contained in the Public Service Regulations and the Public Service Commissioner's Directions. Agency Heads have gained all the rights, duties, responsibilities and powers of an employer (on behalf of the Commonwealth), but there are certain common principles of APS employment which agencies are expected to promote and embody. These include:

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23   ibid., p. 13.

- establishing cooperative workplace relations based on consultation and communication;

- fair and flexible remuneration and conditions of employment;

- a safe and rewarding workplace; and

- freedom of association where, consistent with the Workplace Relations Act, employees are free to choose whether or not to join an industrial association of their choice.

The specific changes arising from the introduction of the Public Service Act relate to the mechanics of agreement making. These include the power of the Agency Head to determine terms and conditions of employment; categories of employment; classification rules; termination of employment; and machinery of government changes. It is Government policy that remuneration and employment conditions for APS employees will continue to be established through agreements made under the Workplace Relations Act.

Financial management reform

A key element of the Government's reforms has been the Commonwealth's financial reform program which has involved the establishment of a revised financial management framework, including accountability and supporting infrastructures necessary to support optimal performance within the new APS environment.

Accrual budgeting

The 1999–2000 financial year saw key elements of this reform program introduced within the Commonwealth. The most significant of these was the adoption of an accrual budgeting framework. The basis of this framework is:

- accrual accounting, budgeting, management and reporting at an organisation level;

- budgeting, reporting and measurement against outputs (the goods and services produced by organisations) and outcomes (the results the government wants to achieve) rather than just against inputs; and

- parliamentary appropriations separately identified for the delivery of outputs.

While organisations had been reporting on an accrual basis for a number of years, the 1999–2000 financial year was the first time that they were required to budget and manage on that basis. At the same time, the new framework resulted in additional financial management responsibilities being devolved to individual organisations from central agencies.

Outputs and outcomes

In line with these changes, the focus of organisational accountability has moved away from the management of cash inputs to the achievement of fully costed outputs and outcomes. This change has posed particular challenges for the APS in developing the necessary financial information to enable organisations to measure their performance.

Goods and Services Tax (GST)

In addition to implementing accrual budgeting requirements, during 1999–2000 organisations were required to manage the impact of a number of other financial initiatives, including the GST. In preparing for the introduction of the GST, public sector organisations were required to examine and re-engineer relevant financial processes and systems.

Competitive tendering and contracting

The *Commonwealth Procurement Guidelines—Core Policies and Principles* notes that agency managers should systematically review agency activities so that they focus on those that are primarily the responsibility of the Commonwealth. Where activities are identified that fall outside the Commonwealth's responsibility, agencies should consider whether these are either best devolved to a more appropriate level of government, privatised or discontinued.

As part of the competitive tendering and contracting arrangements, in May 2000, the Minister for Finance and Administration announced that agencies were to market test their corporate activities, including the human resources services, financial services, records management and facilities and accommodation management.

Benchmarking the Finance Function

A recent ANAO benchmarking study[24]—provides more detailed information on benchmarks for the cost, efficiency, quality and better practice of the individual activities of the finance function. Benchmarking was undertaken against the experience of Commonwealth organisations and against that of a 'Global Group' of international organisations. The report concluded that, while the finance function of organisations benchmarked performed well in many areas in comparison to the 'Global Group', in general, the cost of the finance function overall was greater than that of the 'Global Group.'

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[24] op. cit., ANAO Audit Report, *Benchmarking the Finance Function.*

With reference to payroll activity, the report concluded that, the Commonwealth Group reported high utilisation of both integrated/interfaced payroll/human resources systems and payroll direct deposit which are better practices. However, the overall payroll cost is higher than that of the Global Group while the median cost per pay is lower. The Global Group is 37 per cent more efficient as measured by the median number of pays processed per full time equivalent employee (FTE). The error rate benchmarks of the Commonwealth Group generally indicate a sound performance with the median some 31 per cent lower than that of the Global Group.

In today's APS environment, financial management can no longer be the sole responsibility of a corporate support area; it must be pervasive in all decision-making levels and processes. In order to succeed in this environment, organisations need to understand and manage the cost structures of all outputs to ensure that they are delivered in a contestable and cost effective manner. Without robust financial and management systems and a depth of financial management skills throughout the organisation, organisations will have difficulty meeting these challenges.

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