



3

REPORTING ON PERFORMANCE

AUSTRALIAN NATIONAL AUDIT OFFICE

The ANAO's Scorecard provides an overview of performance based on the performance information contained in the 2005–2006 Portfolio Budget Statements (PBS), which is structured in accordance with the ANAO's Outcome-Output framework.

The performance measures that relate to the three output groups are quantitative in nature and are essentially concerned with issues of efficiency and productivity in delivering audit products. The measures relate primarily to quantity, timeliness and cost.

The outputs' contributions to the achievement of our outcomes are also discussed. These sections relate primarily to the impacts (outcomes) that our outputs have on the Parliament, public sector entities and public sector administration in general. Both quantitative and qualitative measures are used to assess the performance.

This approach provides readers with an understanding of the link between our products (outputs) and their resulting impacts (outcomes). In turn, it will assist readers to assess how cost-effectively we are delivering our products and to what extent we are achieving agreed outcomes.

These sections are followed by an overview and report on our internal management, called 'Management and Accountability'.

2005-2006 PORTFOLIO BUDGET STATEMENTS SCORECARD

Effectiveness – Overall Achievement of Outcomes 1 and 2		
	Target	Actual
Parliament acknowledges the value of the ANAO contribution.	90% value role of ANAO	93% of Parliamentarians surveyed expressed satisfaction with ANAO products and services. ¹
Public sector entities acknowledge the value added by ANAO products and services.	90% value role of ANAO	AASG 93% ² PASG 88% ³
The JCPAA's general satisfaction with the overall quality, timeliness and coverage of our products and services.	High standard of satisfaction	JCPAA survey responses indicate a very high level of satisfaction with ANAO's work ¹ .
Performance information by output component		
Output group 1: Performance Audit Services	Target	Actual
Number of performance audit reports to be produced.	44	46
Percentage of audit recommendations supported by the JCPAA and other Parliamentary Committees.	90%	100%. The JCPAA agreed with all recommendations examined.
Percentage of audits where public sector entities acknowledge the value added by the audit.	90%	99% or 235 of 237 recommendations were either agreed, or agreed with qualification. Two were disagreed. ⁴
Quality assurance results indicate all reviewed audits meet ANAO Auditing Standards.	100% of audits reviewed	100% of audits reviewed. The review found that there was room for improvement in documenting planning and fieldwork phases of performance audits.
Full costs of audit products and services are recorded and reported.	100%	100%

Output Group 2: Information support services	Target	Actual
Number of audit products to be produced (better practice guides).	4	3 The fourth guide was published in August 2006.
Number of client seminar series.	2	2
Percentage completed in accordance with budgeted timeframe.	100%	100%
Seminar topics meet the needs of participants.	75% satisfaction level.	93% ⁵
Output Group 3: Assurance audit services	Target	Actual
Number of financial statement audit opinions to be issued.	260	246 ⁶
Number of audit products produced (6 business support process audits and one protective security audit).	7	4 (3 business support process audits and 1 protective security audit). Another three business support process audits are in progress.
Financial statement related reports.	2	2 ⁷
Number of other audit opinions.	2	2 ⁸
Timeliness of issuing financial statement audit opinions.	100%	79% issued on, or within two days of signing the financial statements.
Percentage completed in accordance with agreed timeframes (financial statements).	100%	76%. This was largely attributed to difficulties in managing the preparation of the financial statements. To help promote improvement in this process, we published a comprehensive better practice guide on the preparation of financial statements in April 2006.
Quality assurance results indicate all reviewed audits meet ANAO Auditing Standards.	100%	100% of audits reviewed. Documentation of audit risks and related audit approaches were identified as areas for improvement.
Full costs of audit products and services are recorded and reported.	100%	100%

- Notes: 1. Parliamentary Survey, May 2005 (a biennial survey).
 2. AASG Client Survey, June 2006.
 3. PASG Client Survey, February 2006.
 4. These recommendations often include several parts to ensure clarity. Of the 237 full recommendations 211 (89 per cent) were fully agreed in all parts, 24 (10 per cent) were agreed overall, but with some qualification or minor disagreement. One full recommendation was disagreed and one disagreed in the majority of its parts.
 5. Seminar feedback forms.
 6. The actual number of audit opinions is dependent on government decisions on entity structures.
 7. Not reported separately in the 2005–2006 PBS.
 8. Triple bottom line reports for the Department of Family and Community Services and Indigenous Affairs, and the Department of the Environment and Heritage.

2005–2006 BUSINESS PLAN SCORECARD

As well as the targets set in the Portfolio Budget Statements, our 2005–2006 Business Plan included a number of additional targets, which are set out below.

Activity	Target	Actual
Staff satisfaction is at an acceptable level.	>70%	71% ¹
Staff turnover is at an agreed level.	<18% turnover	19% ² ANAO operates in a highly competitive market for accounting skills. Recruitment and retention strategies are being implemented.
Public sector organisation acknowledge understanding and skills of ANAO staff through client satisfaction surveys.	90% of agencies rate ANAO staff skills as '4' or above. ³	PASG 88% (28% strongly agreed – '5' rating, and 60% agreed – '4' rating) ³ AASG 95% (31% strongly agreed – '5' rating, and 64% agreed – '4' rating) ³
Professional development programs result in an improvement in the level of performance of staff.	Staff and supervisors acknowledge an improvement in the level of on-the-job performance.	80% surveyed considered the new skills acquired improved on the job performance. ¹
Staff acknowledge ANAO Values and Behaviours are exhibited in the workplace.	85%	89% ¹
Implementation of Business Plan action items within agreed timeframes and standards.	100%	All projects have been completed with some, as in the case of the Workforce Plan, being progressively implemented.

- Notes: 1. ANAO Staff Survey, May 2006.
 2. This is an ANAO wide target, which measures the number of staff leaving as a percentage of total ANAO staff.
 3. A rating of '4' means respondents agree and a rating of '5' means they strongly agree.

OUTPUT GROUP 1

PERFORMANCE AUDIT SERVICES

Output Group 1 comprises performance audit reports and other performance audit and related products.

The following summarises the ANAO's performance in producing these outputs in 2005–2006. Details of financial resources for performance audit services are set out in Tables 1 and 2 of this report.

PERFORMANCE AUDIT REPORTS

The *Auditor-General Act 1997* (the Act) allows the Auditor-General to conduct, at any time, a performance audit of an agency, a Commonwealth authority or company, other than a Government Business Enterprise (GBE) or any of its subsidiaries. The Auditor-General may conduct a performance audit of a fully owned GBE or its subsidiaries if the responsible Minister, the Finance Minister or the Joint Committee of Public Accounts and Audit (JCPAA) requests the audit. The Act defines a performance audit as a 'review or examination of any aspect of the operations of a body or person'. In accordance with accepted auditing practice, performance audits are an independent, objective and systematic examination of the operations of a body for the purposes of forming an opinion on whether:

- management of the operations has been economical, efficient and effective;
- internal procedures for promoting and monitoring economy, efficiency and effectiveness are adequate; and
- improvements might be made to management practices (including procedures for promoting and monitoring performance).

Typically performance audits examine resource use, information systems, performance measures, monitoring systems and legal compliance. Audits are conducted in accordance with ANAO Auditing Standards. Our performance audit reports are tabled in the Parliament.

In seeking to improve administration, performance audits identify better practices, when observed, which may then be incorporated into 'better practice' guides for dissemination throughout the Australian Government public sector. These guides are discussed under Output Group 2.

Because of the size, complexity and diversity of most Australian Government entities, a performance audit usually examines selected segments of their operations. General (cross-portfolio or cross-agency) performance audits examine the same issue or activity in a number of entities and the findings may have application across the Australian Government public sector.

Audit topics are selected on two grounds:

- where an audit can be expected to add the greatest value in improved accountability, economy, efficiency and administrative effectiveness; and
- to ensure appropriate coverage of entity operations within available audit resources.

PERFORMANCE AUDIT WORK PROGRAM

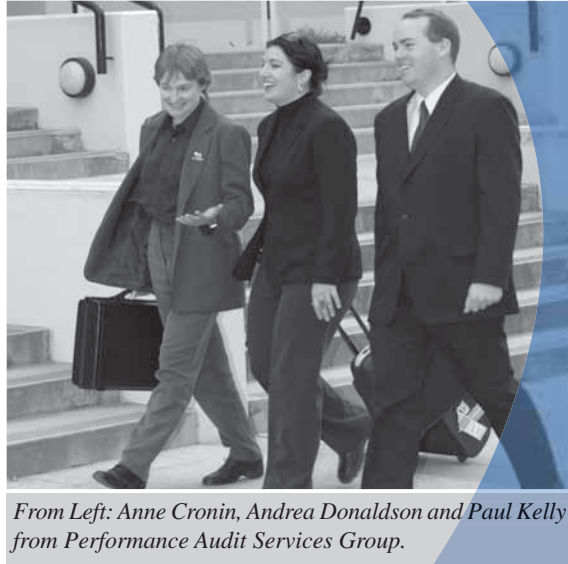
The ANAO's *Audit Work Program*¹ is developed annually in close consultation with the JCPAA and agencies. The JCPAA also seeks and coordinates comments from

other Parliamentary committees on the ANAO's draft *Audit Work Program*. This process is to ensure that our audit products and outputs meet the needs of the Parliament and public sector bodies, and are in tune with the key risks and challenges facing the Australian Government in a rapidly changing world. These risks and challenges are taken into account in identifying the key areas of focus in developing the annual performance audit work program and in evaluating and assessing potential financial statement issues to be addressed during the course of financial statement audits.

Audit activity is planned having regard to business risks; financial materiality; program significance; audit impact; visibility of the program; the extent of recent audit coverage; and broad themes derived from the audit work planning process.

The performance audit themes identified in the 2005–2006 *Audit Work Program* are set out below.

- security;
- economic management;
- service delivery and whole-of-government approach;
- health and ageing;
- IT and its use across agencies;
- governance arrangements; and
- project management.



From Left: Anne Cronin, Andrea Donaldson and Paul Kelly from Performance Audit Services Group.

¹ Available on the ANAO's website <<http://www.anao.gov.au>>

PERFORMANCE AUDIT OUTCOMES BY THEMES

Below are examples of audit outcomes against the various audit themes. The main issues raised in the audit reports are summarised by themes in Appendix 4.

SECURITY

Security is an area of continuing concern and sensitivity. Several audit reports tabled during the year concerned this theme. One audit assessed the effectiveness of the key evaluation methods used to review the efficacy of the Australian Government's national counter-terrorism coordination arrangements. It also examined the effectiveness of the links between the key evaluation methods and how those methods contribute to continuous improvement. A review of passenger processing addressed one of the elements of Australia's border control – whether travellers to Australia have a valid passport and visa. A follow-up audit of quarantine and biosecurity effectiveness found substantial progress had been made in implementing recommendations made previously by the ANAO and JCPAA. This audit identified that the quantity of prohibited material undetected at airports and mail centres had decreased substantially since the last audit.

ECONOMIC MANAGEMENT

Building on previous work in the general area of economic management, a follow-up audit of bank prudential supervision found that progress had been made in implementing previous ANAO recommendations and that a new risk rating process and supervision framework had been implemented. However, an audit of Australian financial services licensing found that important regulatory risks were not systematically addressed until after the end of the transition period from the previous licensing system. In post-sale management of privatised rail business contractual rights and obligations, departments were found not to have adequately assessed whether value for money was being achieved for the Commonwealth when entering into contracts with the privatised rail provider. Although difficult to quantify, the cash economy and the revenue risk it poses require more attention to secure better compliance in business-to-consumer cash dealings and to show the impact of compliance activities on targeted cash economy industries. Green procurement was also reviewed, highlighting significant shortcomings in agencies' application of whole-of-life costing and managing environmental impacts of procurement decisions.

SERVICE DELIVERY AND WHOLE-OF-GOVERNMENT APPROACH

An ongoing challenge for Australian Government agencies is to meet increasing expectations of the government and the Australian community to provide high quality and cost effective services. An audit of management of job placement and matching services for job seekers considered the extent to which Government systems facilitate matching of job seekers to vacancies. A follow-up audit of Commonwealth State housing agreement administration found improved systems for performance and financial information used to measure whether housing assistance was targeted to those most in need. An audit of the roads to recovery program demonstrated the importance of program management and accountability mechanisms giving reasonable assurance that road projects are undertaken in accordance

with the scope and timelines proposed by local government authorities. A follow-up audit of petroleum and tobacco excise collections found that substantial quantities of tobacco are diverted into the illegal market from Australia's tobacco plantations, an issue that is now being addressed.

HEALTH AND AGEING

A strong primary care system is a key element in providing quality care in treating illness and preventing health problems through early intervention. An audit assessed administration of primary care funding through a review of funding agreements, monitoring arrangements, payments, and support for administrators. It found good progress in providing guidance to officers who administer funding agreements and that approaches are being strengthened by developing an information system to support agreement administration. A follow-up audit on administration of the 30 per cent private health insurance rebate found that administration of the rebate is effective but there are opportunities for improving agencies' administration. An audit of coordination and monitoring roles under the Commonwealth State disability agreement found that these roles were undertaken effectively but that performance monitoring and reporting need to improve in order to gauge whether expenditure under the agreement is improving the quality of life of people with a disability.

IT AND ITS USE ACROSS AGENCIES

The Commonwealth has a significant investment in information technology (IT) to support program objectives. Government policy provides for agencies to use the Internet to deliver appropriate programs and services. Although agencies increasingly rely on the Internet, an audit of Internet security found that, of the agencies audited, most had insufficient Internet security. Improvements could be made in email filtering, managing Internet security and developing system security plans. A protective security audit of IT security management concluded that audited entities had identified relevant Government policies, practices and procedures for protecting information but there were opportunities for improving their policies and procedures on IT security management practices, risk assessment processes, identification of physical and environmental controls for managing IT equipment and reporting network security practices. Another audit, of Centrelink's large and complex IT systems that support its extensive business operations, found that Centrelink's electronic customer records are generally sufficiently accurate and complete to support effective administration of social security programs for which Centrelink is responsible. Australian Taxation Office management of high risk refunds (HRRs) and controls over IT systems to process activity statement refunds to taxpayers was examined.

GOVERNANCE ARRANGEMENTS

Governance arrangements continue to be a key consideration for good public service administration and this year our reports covered a range of governance issues. An audit of private health insurance regulation concluded that the regulator's overall governance and organisation supported the performance of its legislative functions and that its administrative effectiveness was sound. The Government's arts support program, Artbank, was reviewed and it was found that it was meeting its charter by acquiring contemporary art for rental and display in public places but that governance arrangements

and operational matters could be improved. An examination of the management of net appropriation agreements revealed widespread shortcomings and that agencies have given inadequate attention to effective arrangements that support additions to annual appropriations and expenditure of those amounts. Our work on the contract tender processes for immigration detention services provided useful observations about governance arrangements for large procurement projects. The audit of arrangements for aid funds under the Australia-Indonesia partnership for reconstruction and development, found progress had been made in a number of important areas, such as in establishing high-level overview arrangements, but that risk management and procurement arrangements required strengthening.

PROJECT MANAGEMENT

Project management is the application of knowledge, skills, tools and techniques to a range of activities in order to meet task requirements. It focuses on producing a defined output by a certain time, to a defined quality and with a given level of resources so that planned outcomes are achieved. It is an aspect of research grant management. An audit of research grants management concluded that statutory requirements were met in administering grants for basic and applied research but that effectiveness, transparency and accountability of grants administration could be improved. Several audits were completed as part of our strategy to examine Defence projects that manage and upgrade weapon systems and associated equipment. These included an audit of lessons learnt from the Jindalee Operational Radar Network Project's acquisition and acceptance phase. Another concerned the Orion maritime patrol aircraft fleet upgrade project, which found that the project encountered delays and difficulties but met performance objectives. An audit of management of Defence's Tiger armed reconnaissance helicopter project found that the project encountered difficulties delivering the required capability for the specified price and within the required time frame.

INCLUSION OF AGENCY COMMENTS IN AUDIT REPORTS

Maintaining a relationship of professional co-operation with the audited body during an audit is of crucial importance to the ANAO. To facilitate this, the ANAO consults fully with agencies during the planning stages, provides early information on the audit approach and objectives, maintains open and regular communication with the audited body, and advises audit conclusions and proposed recommendations as soon as practicable. In addition, under section 19 of the Act, the Auditor-General provides a copy of the proposed report to the audited agency. If the recipient of the proposed report gives written comments to the Auditor-General within 28 days of receiving the report, the Auditor-General must consider them before preparing a final report.

In its Report 386 *Inquiry into the Auditor-General Act 1997*, tabled in September 2001, the JCPAA recommended a number of amendments of the Act. One recommendation was that the Auditor-General include agency comments on a proposed report in full in the final report. The Government agreed to this recommendation. Amending legislation will be introduced into the Parliament in conjunction with other amendments of the Act, but the Auditor-General decided that he would give effect to this change prior to a legislative requirement to do so. Consequently, for each report tabled in 2005-2006, agency comments were included in full in the final report.

PERFORMANCE

The primary performance attributes for this output relate to the number of reports produced and their cost and quality. Quality targets for performance audit reports are set out in our Business Plan, reported in the ANAO Scorecard in the previous section and also discussed under ‘Contribution to Outcomes’.

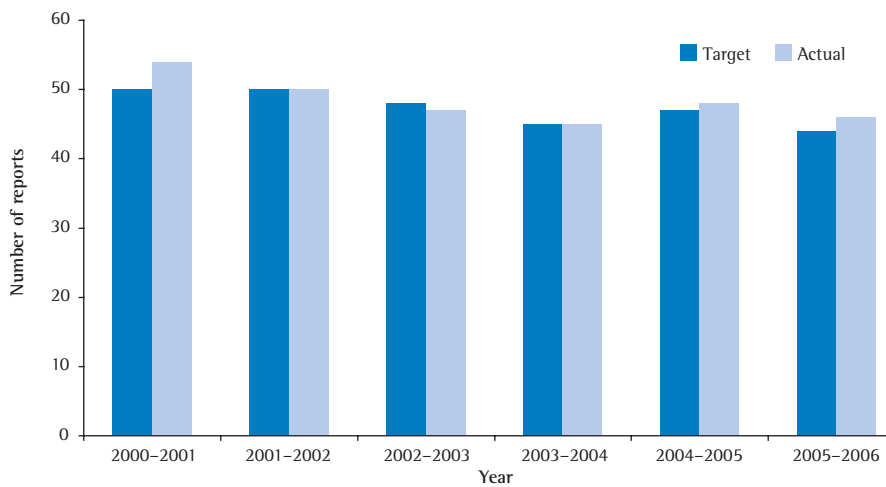
AUDIT METHODOLOGY

Planning for enhanced working paper management for performance audit has commenced as part of a wider ANAO project to procure an electronic document record management system.

NUMBER OF REPORTS

During the year 46 performance audit reports were produced against a target of 44 for this output. For 2004–2005 the comparable figures were 48 and 47. Figure 3 shows the number of reports produced under this output over the past six years.

FIGURE 3: NUMBER OF PERFORMANCE AUDIT REPORTS



AVERAGE TIMEFRAMES AND COSTS

The average time taken to complete a performance audit report was 11.7 months, with a range from 7 to 19 months. The average cost (including overhead allocation) was \$0.403 million with a range from \$0.221 million to \$0.809 million.

COST OF PERFORMANCE AUDIT SERVICES

The performance audit reports output (Output Group 1) consumed \$19.136 million in 2005–2006 (\$21.470 million in 2004–2005).

OTHER AUDIT AND RELATED PRODUCTS

The ANAO produces other audit-related products as part of its integrated audit services' delivery. Those products are summarised below.

AUDIT WORK PROGRAM

During the latter half of 2005-2006 the Audit Work Program 2006-2007 was developed in consultation with the JCPAA and agencies and provided to the Prime Minister, Leader of the Opposition, Ministers, Shadow Ministers, the JCPAA and agency heads. The JCPAA takes the lead role in coordinating parliamentary input to the development of the program. The program outlines performance audits in progress at 1 July 2006 and lists performance audit topics from which audits for 2006-2007 are selected. It also sets out in summary form the work programs intended to be undertaken by the other ANAO Output Groups, namely Assurance Audit Services and Information Support Services, which are discussed later in this report.

CONTRIBUTION TO OUTCOME 1— IMPROVEMENT IN PUBLIC ADMINISTRATION

Performance audit services are the primary contributor to the ANAO's achievement of Outcome 1—Improvement in public administration. In turn, the extent to which the outcome is being achieved is largely gauged by the impact of performance audit outputs on the Parliament, as the ANAO's principal stakeholder, and the client entities being audited.

Outcome 1 is measured through targets and survey results designed to provide an overall picture of the contribution that our products and services make to the Parliament and public sector entities. Key performance information is presented in our scorecard in the previous section. The scorecard result is supported by other performance information discussed below. The final section outlines the impact of the outputs in potential annual recurring financial benefits to the Commonwealth.

CLIENT SURVEY

After each performance audit report is tabled, feedback on the audit process is sought independently from the senior manager responsible for the audited program by means of a questionnaire and an interview with the responsible manager. This evaluation is performed by a firm of consultants that works to the ANAO but is independent of the performance audit teams.

In the February 2006 survey the consultancy firm reported on responses received for the 2004-2005 reporting period. Overall, the ANAO's performance was rated as consistent with the level achieved in the previous year and marginally higher than the average level recorded since the survey began in 1997-1998. In this report, 46 of the 66 selected public entity areas participated in the survey. This represents a response rate of 70 per cent, down on last year's 80 per cent. The reduced response rate

is largely explained by the finding that 16 of the 20 who did not respond to the survey were involved in cross agency performance audits. We have found that there is a tendency for auditees involved in cross agency audits not to become involved in client surveys as they have much less contact with the ANAO compared with single agency audits.

In terms of overall performance, agencies rated the ANAO's conduct of performance audits positively. Some key results are set out below:

- 88 per cent of respondents considered that the audit team demonstrated that they had the professional knowledge and audit skills required to conduct the audit;
- 84 per cent of respondents considered that the audit teams' conduct was characterised by integrity, and an ethical approach to their task; and
- 88 per cent of respondents valued the independent opinion expressed by the ANAO.

The results of the survey are an important guide to the effectiveness of existing practice and also in the development of new initiatives. The survey is therefore an important business tool for improving the quality and effectiveness of performance audit products and services.

CONTRIBUTION TO THE PARLIAMENT

The contribution of performance audit services to the work of the Parliament is measured, in part, by a review of comments in Parliamentary committee reports and at committee hearings. Parliamentary committee review of audit reports gives an impetus to entities in their implementation of audit recommendations and to the positive outcomes from performance auditing. As indicated below, committees continued to be supportive of audit findings.

JCPAA

The JCPAA reviews all audit reports and conducts public inquiries into selected audit reports. The ANAO gives evidence at these inquiries and assists the JCPAA in its review work. The JCPAA tabled *Report 404 Review of Auditor-General's Reports 2003–2004 Third and Fourth Quarters; and First and Second Quarters of 2004–2005* in October 2005. The report reviewed audit reports on intellectual property policies, greenhouse programs, the Dairy Industry Adjustment Package, client service in the Family Court and Federal Magistrates Court, federal airport leases; Centrelink customer debt, the Standard Defence Supply System Upgrade, special appropriations, container examination facilities, non-prescription medicinal product, and entities' financial statements for 2003–2004.

The JCPAA indicated its support for the audit reports reviewed, noted agencies' advice of implementation of the ANAO recommendations, and made recommendations consistent with those made by the ANAO.

The JCPAA also held hearings into a number of ANAO audits. The relevant JCPAA reports had not been completed by the end of June 2006. The reports examined by the JCPAA in 2005-2006 are listed below:

Audit Report No.22 2004-2005 *Investment of Public Funds*;

Audit Report No.42 2004-2005 *Commonwealth Debt Management (Follow-up audit)*;

Audit Report No.30 2004-2005 *Regulation of Commonwealth Radiation and Nuclear Activities*;

Audit Report No.31 2004-2005 *Centrelink's Customer Feedback Systems-Summary Report* (ANAO Report Nos.32-36 inclusive) and Audit Report No.40 2004-2005 *The Edge Project*;

Audit Report No.45 2004-2005 *Management of Selected Defence System Program Offices*;

Audit Report No.50 2004-2005 *Drought Assistance*;

Audit Report No.51 2004-2005 *DEWR's oversight of Job Network services to job seekers*;

Audit Report No.58 2004-2005 *Helping Carers: the National Respite for Carers Program, Department of Health and Ageing*;

Audit Report No.3 2005-2006 *Management of the M113 Armoured Personnel Carrier Upgrade Project, Department of Defence*;

Audit Report No.6 2005-2006 *Implementation of Job Network Employment Services Contract 3*;

Audit Report No.2 2005-2006 *Regulation of the Office of the Gene Technology Regulator*;

Audit Report No.11 2005-2006 *BSP Senate Order for Departmental and Agency Contracts*;

Audit Report No.17 2005-2006 *Administration of the Superannuation Lost Members Register*;

Audit Report No.21 2005-2006 *Audits of the Financial Statements of Australian Government Entities for the period ended 30 June 2005*;

Audit Report No.23 2005-2006 *IT Security Management*;

Audit Report No.27 2005-2006 *Management and Reporting on Expenditure on Consultants*;

Audit Report No.28 2005-2006 *Management of Net Appropriation Agreements* ;

Audit Report No.29 2005-2006 *Integrity of Electronic Customer Records*;

Audit Report No.31 2005-2006 *Roads to Recovery*;

Audit Report No.32 2005-2006 *Tender for Detention Centre Contract*; and

Audit Report No.34 2005-2006 *Advance Passenger Processing*.

The House of Representatives Standing Committee on Environment and Heritage reviewed Audit Report No.22 2005–2006 *Cross-Portfolio Audit of Green Office Procurement*. The Committee commented positively on the report. The Chairman noted that the report was very comprehensive and enlightening for members of the Committee.

The House of Representatives Standing Committee on Economics, Finance and Public Administration will be reviewing Audit Report No.25 2005–2006 *ASIC's Implementation of Financial Services Licences* in the coming year.

In addition a submission was prepared and evidence was provided to the Senate Legal and Constitutional References Committee's inquiry into the administration and operation of the *Migration Act 1958*.

We also provided a submission and gave evidence to the Joint Standing Committee on Migration's review of Audit Report No.1 2005–2006 *Management of Detention Centre Contracts – Part B*.

ANAO AUDITS UNDERTAKEN BY FORMAL REQUEST OF THE PARLIAMENT OR MINISTERS

Audit Report No. 11 of 2005–2006 *The Senate Order for Departmental and Agency Contracts (Financial Year 2004–2005 Compliance)* was conducted at the request of the Senate. This audit examined FMA Act agencies' compliance with the Senate Order for Departmental and Agency Contracts, first issued on 20 June 2001. The audit was the seventh audit in a series of audits commencing with Audit Report No.33 2001–2002. The eighth audit is currently in progress.

Audit Report No.19 2005–2006 *Managing for Quarantine Effectiveness—Follow-up* was undertaken at the request of the JCPAA.

An audit of implementation of the Parliamentary resolutions arising from the *Review by the Parliamentary Service Commissioner of Aspects of the Administration of the Parliament* arose from advice by the JCPAA in 2003 that administration of the parliamentary departments represented an audit priority of the Parliament.

Three audits were requested by the Parliament and accepted by the Auditor-General:

- administration of the Regional Partnerships Program (requested by the Senate Finance and Public Administration References Committee);
- processes for receiving and referring for investigation statutory reports of suspected breaches of the *Corporations Act 2001* (requested by the Joint Committee on Corporations and Financial Services); and
- Australian Pesticides and Veterinary Medicines Authority (requested by the Parliamentary Secretary to the Minister for Agriculture, Fisheries and Forestry).

In addition, the Minister for Transport and Regional Services requested a review of Airservices Australia's administration of a contract with the Government of the Solomon Islands.

CONTRIBUTION TO PUBLIC SECTOR ENTITIES

Implementation of recommendations made in audit reports is not mandatory and they must stand on their merits. A major outcome from the ANAO's performance audit work is improvement in management and administration of major Australian Government programs brought about by entities' acceptance and implementation of recommendations made in audit reports. These recommendations are also expected to yield significant efficiencies or financial benefits, further enhancing the cost-effectiveness of performance auditing. Performance audit reports also provide significant assurance to the Parliament about the way an area of public service is being conducted.

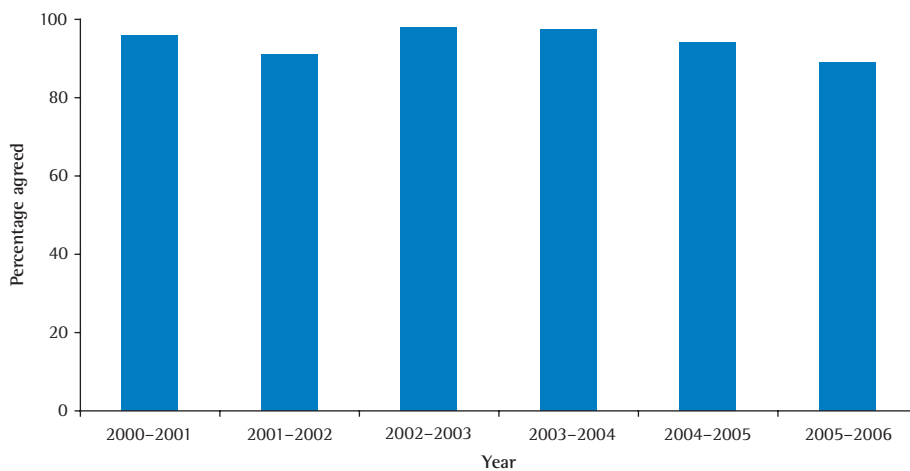
AGREEMENT TO RECOMMENDATIONS

Improvements in administration, accountability and better service delivery are more likely to occur if the recommendations in performance audit reports are agreed by the audited entity at the time of the audit, and we make genuine efforts to achieve this result. However, irreconcilable differences will occur on some occasions and when this happens, agency comments are included in full in the final report.

For 2005-2006 we made 237 recommendations in our audit reports to improve agency performance and accountability. These recommendations are sometimes broken down into components for clarity such that it is possible to agree with parts of one recommendation and disagree with other parts. Of the 237 recommendations 211 (89 per cent) were fully agreed in all parts, 24 (10 per cent) were agreed overall, but with some qualification or a minor disagreement. One full recommendation was disagreed and one disagreed in the majority of its parts.

This is similar to last year's result where 94 per cent of our recommendations were fully agreed and six per cent were agreed with qualification. Figures for the last six years are shown in Figure 4.

FIGURE 4: AGREEMENT TO RECOMMENDATIONS IN PERFORMANCE AUDIT REPORTS



FINANCIAL IMPACT

Three reports tabled in 2005–2006 indicated that savings could be made by implementing audit recommendations. Audit Report No.22 2005–2006 *Cross-Portfolio Audit of Green Office Procurement* estimated annual savings of almost \$10 million could be achieved if agencies were more proactive in energy and water conservation in particular. Audit Report No.27 2005–2006 *Reporting of Expenditure on Consultants* estimated annual savings of at least \$2.6 million could be achieved from rationalising reporting mechanisms. Audit Report No.31 2005–2006 *Roads to Recovery* identified costs of between \$8.4 million and \$19.4 million resulting from delays in the use of funds for roadworks by local governments. The audit found that better matching of program payments to local government would eliminate these costs in the second Roads to Recovery Program, which commenced on 1 July 2005.

QUALITY ASSURANCE

The ANAO continued its program of quality assurance reviews of selected performance audits. The objective of the quality assurance program is to ensure that performance audits have been completed in accordance with ANAO Auditing Standards, incorporating Australian Auditing and Assurance Standards. Interim results of the review of audits tabled in 2005–2006 found that across the audits examined there was general compliance with these standards. It was found there was room for improvement in documenting planning and fieldwork phases of performance audits.

A Peer Review arrangement for performance audits involving Australia and the New Zealand Audit Offices began in 2000. This review supplements the ANAO's quality assurance program with two performance audits from each Office reviewed every two years. Peer review with New Zealand is approached with a dual focus of compliance and adding value. During 2005 a New Zealand team reviewed two ANAO performance audits. The team reported to the Auditor-General that:

- the audits had followed the prescribed procedures and processes;
- the audits had been conducted in a manner consistent with sound auditing practice;
- the reports were of a high quality, tackling complex subjects through a highly professional and robust audit approach; and
- there were opportunities for improvement by building on existing ANAO practice.

Steps are being taken to address the improvement opportunities identified by the Peer Review.

OUTPUT GROUP 2

INFORMATION SUPPORT SERVICES

Output Group 2—Information Support Services (ISS) covers a range of services delivered by a variety of areas across the ANAO. The outputs that comprise Outputs Group 2 in 2005–2006 are:

- assistance to the Parliament;
- client seminars;
- national and international representation; and
- better practice guides.

The ISS aims to provide the Parliament with general assistance relating to relevant management and service-wide issues and audit clients with practical insights into achieving better financial management and control within their own organisations. The ANAO also contributes, and benefits from, the work or experience of the global auditing community.

ASSISTANCE TO PARLIAMENT

Consistent with past practice, the ANAO continued to liaise closely with the Parliament by providing briefings to Ministers, Shadow Ministers, other members of Parliament, Parliamentary Committees and their staff on audit reports tabled in the Parliament.

The assistance to Parliament output cost \$0.503 million in 2005–2006 (\$0.333 million in 2004–2005).

BETTER PRACTICE GUIDES (BPGs)

BPGs aim to improve public administration by providing a mechanism whereby better practices employed in organisations are recognised and promulgated to all Australian Government entities. This can involve examining practices in the public or private sectors, in Australia or overseas. Our emphasis is to identify, assess and articulate good practice from our knowledge and understanding of the public sector as well as areas where improvements are warranted.

Depending on the subject and nature of information collected during an audit, BPGs may be produced in conjunction with an audit or prepared as a result of a perceived need to provide guidance material in a particular area of public administration.

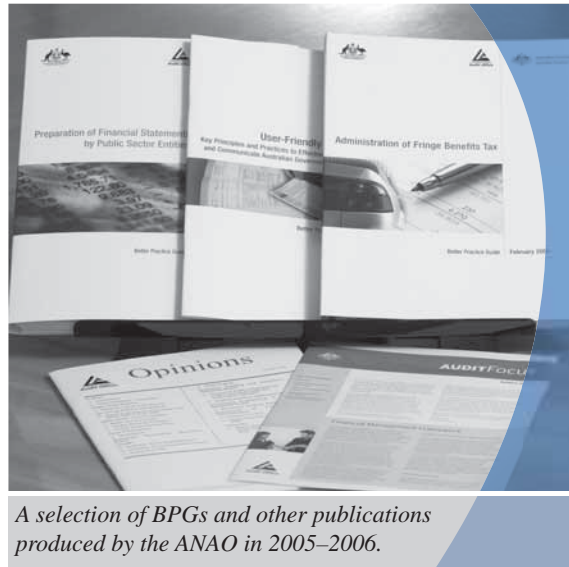
PERFORMANCE

The primary performance measure for this output is the number of products and services published during the year. In 2005–2006, three BPGs were published against a target of four, noting that the fourth guide was published in August 2006. Our BPGs continue to be well-received by entities, other audit offices and professional organisations.

BPGS PUBLISHED IN 2005-2006

The three BPGs published in 2005-2006 are described below.

User-Friendly Forms: Key Principles and Practices to Effectively Design and Communicate Australian Government Forms (January 2006). This Guide aims to increase the useability and effectiveness of forms provided by agencies to individuals, to support service delivery and to satisfy other government objectives. It is intended as a reference for people responsible for the design and testing of Australian Government forms.

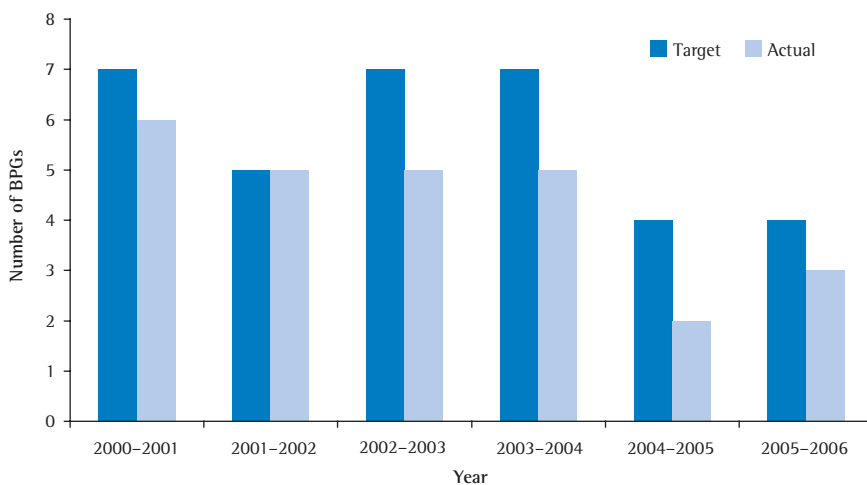


Administration of Fringe Benefit Tax (February 2006). This Guide outlines better practices for administration of FBT and provides practical guidance on managing a range of benefits commonly provided by Australian Government entities. It is intended to complement, not be a substitute for, existing Tax Office FBT guidance.

Preparation of Financial Statements by Public Sector Entities (April 2006). This Guide was prepared to assist entities in meeting their financial reporting responsibilities. It discusses factors that contribute to the successful preparation of an entity’s financial statements, as well as providing examples and checklists of documents typically generated as part of the financial statement process.

Figure 5 shows this years’ result compared to the number of BPGs produced over the last six years.

FIGURE 5: NUMBER OF BPGS PRODUCED



COST

BPGs cost \$1.590 million in 2005–2006 (\$0.349 million in 2004–2005). These figures are a reflection of total costs incurred from BPGs in the relevant year, including the proportion of costs incurred where work carries over from a previous year and work in progress for reports not yet completed. The difference in cost reflects an increase in the number of BPGs from two in 2004–2005, to three in 2005–2006 and includes the cost of three further guides underway.

INCREASING AWARENESS OF BPGS AND RELATED PRODUCTS

During 2005–2006, ANAO officers continued to participate in a number of APS forums, seminars and conferences to increase awareness of various BPGs and other audit reports. We encourages entities to use BPGs to review their own arrangements and practices.

NATIONAL AND INTERNATIONAL REPRESENTATION

INTERNATIONAL REPRESENTATION

The ANAO contributes to the development of international Auditing Standards and professional practices through the exchange of experiences and information with the following bodies:

- International Organisation of Supreme Audit Institutions (INTOSAI);
- Asian Organisation of Supreme Audit Institutions (ASOSAI);
- Commonwealth Auditors-General Conferences;
- Auditors-General Global Working Group (GWG); and
- International Auditing and Assurance Standards Board (IAASB).

In meeting our responsibilities to these organisations, the Auditor-General and selected staff typically attend international conferences and workshops, participate in short-term placements and prepare research papers.

The ANAO is a member of the INTOSAI Professional Standards Committee and the INTOSAI Working Group on Privatisation. We contribute to this Working Group by sharing information on our own experiences and commenting on draft documents. A representative from the ANAO attended a Working Group meeting in Brazil in September 2005.

A Performance Audit Sub-committee of the Professional Standards Committee was established after approval by the INTOSAI Governing Board in November 2005. The mandate for the subcommittee includes developing standards and guidelines for performance auditing and monitoring developments and reforms in regard to performance audit. We accepted a nomination to represent ASOSAI on the Performance Audit Sub-committee in February 2006. We provided feedback on the development of the formation process, draft terms of reference and work plan.

In January 2006 INTOSAI invited the ANAO to participate as a member of the newly established *Task Force on the Accountability and Audit of Disaster and Related Aid*. The first full meeting of the Task Force took place in Geneva in March 2006, which was attended by the Deputy Auditor-General. The discussion covered a range of issues including: goals; the use of Development Assistance Databases for the tracking of aid flows (supported by the United Nations Development Program); the added value of geographical information systems for auditing aid flows; and the Financial Tracking Service of the United Nations Office for the Coordination of Humanitarian Affairs.

We also accepted an invitation to be a member of the Indonesian Audit Office's (BPK) advisory board. The Advisory Board will assist the BPK in enhancing its capacity and capability to audit the management of international donor funding. In April 2006, the Auditor-General attended the inaugural meeting of the Advisory Board to BPK on its Tsunami-funds audit strategy. As part of our continuing dialogue with Indonesia, a delegation of three senior members of the Indonesian Board of Audit visited the ANAO in February 2006. Shortly after, two senior ANAO officers visited the Board of Audit to identify priorities for capacity building.



Alan Thompson (far left), Paul Nicoll (second from the left) and Steve Chapman (third from the right), with three senior members of the Indonesian Board of Audit.

The Auditor-General is the only Australian representative on the International Auditing and Assurance Standards Board (IAASB), which functions as an independent standard setting body under the auspices of the International Federation of Accountants. The mission of the IAASB is to establish high quality auditing, assurance, quality control and related services standards. It also aims to improve the uniformity of practice by professional accountants throughout the world, thereby strengthening public confidence in the global auditing profession and serving the public interest. The Auditor-General attended meetings of the Board during the year.

The ANAO contributes to the development of other audit offices by hosting a number of international visitors throughout the year. During this year, we hosted 34 short-term visits for 319 delegates, from a number of countries including Thailand, Brazil, South Africa, Korea, China, Vietnam, United Kingdom, Indonesia and Papua New Guinea. Overall, delegates provided very positive feedback on their visit.

In addition, we have a senior officer seconded to the Papua New Guinea (PNG) Audit Office as our contribution to the PNG Enhanced Co-operation Program.

Our international staff exchange program with the Office of the Comptroller and Auditor-General of Ireland and the Office of the Auditor-General of Canada continued this year. More information on these exchanges may be found under 'Management of Human Resources' in the 'Management and Accountability' section of this report.

NATIONAL REPRESENTATION

At the national level, the ANAO is a member of the Australasian Council of Auditors-General (ACAG). ACAG comprises the Auditor-General of each Australian State and Territory, Fiji, New Zealand and Papua New Guinea. ACAG's objective is to promote public sector auditing in the Australasian region through an exchange of experiences, ideas, training initiatives and cooperation. We contribute to ACAG's work by attending business meetings, preparing papers, participating in information exchanges, peer reviews and training. We also hosted an ACAG meeting in Canberra in May 2006.

As a member of the Australian Auditing and Assurance Standards Board, the Auditor-General attended Board meetings during 2005-2006.

COST

The national and international representation output cost \$0.317 million in 2005-2006 (\$0.587 million in 2004-2005).

CLIENT SEMINARS AND ADVICE

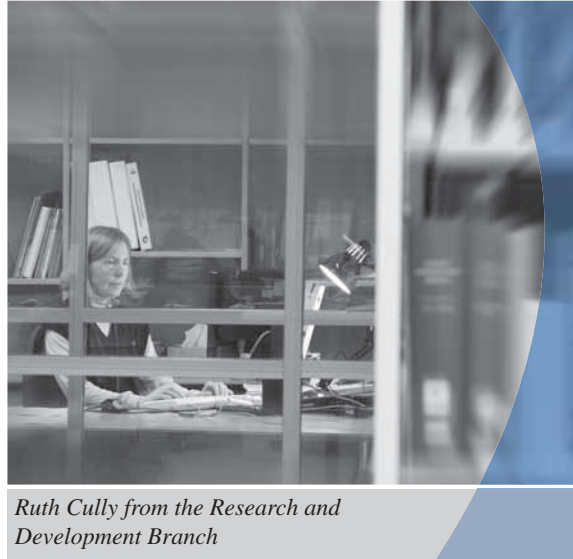
In addition to its primary role of providing independent assurance and advice to the Parliament, we also seek to support and advise audit clients where this complements our primary role and is within our area of expertise.

The ANAO arranges seminars to provide advice on topical and emerging issues. The focus of this activity is directed towards improving financial reporting. Two series of five financial reporting seminars were conducted in 2005-2006 in Canberra, Sydney and Melbourne. The first series was conducted in February and March 2006 and the second series in June 2006. As in previous years, these seminars generated a great deal of interest and were well received by attendees. Seminar feedback forms from the February and March 2006 seminars revealed that 93 per cent of participants were satisfied that the seminar had met their needs.

During the year a number of ANAO staff accepted invitations to speak to Australian Government organisations and other bodies on topical issues and issues arising from audit reports and BPGs. More information on these presentations may be found at Appendix 5.

ANAO NEWSLETTERS

The ANAO produces two newsletters, namely *Opinions* and *AuditFocus*, to provide technical information and audit related items of general interest. These are described in more detail below.



Ruth Cully from the Research and Development Branch

OPINIONS

Opinions is a newsletter that provides audit clients with information on developments in financial reporting and disclosure, together with details of recent performance audit reports and better practice guides. It also lists audits scheduled for completion in the near future. *Opinions* has a wide distribution including Chief Executives, Chief Financial Officers, Heads of Internal Audit and other audit offices. Editions of *Opinions* were published in August and December 2005, and in March 2006.

AUDITFOCUS

Due to its broad mandate, the ANAO is in a unique position to observe public sector administration—what works and what doesn't. During the year we commenced the production of the newsletter *AuditFocus*, which captures the lessons from our audit work that are likely to be of general interest and application. During 2005–2006, two editions of the newsletter were published and included articles on a range of issues including compliance with the APS financial framework, maintaining proper records, project and contract management, effective management of regulatory functions, managing conflicts of interest and information technology issues. We expect to publish *AuditFocus* three times a year; copies are available on the ANAO website.

COST

The client seminars and advice output cost \$0.016 million in 2005–2006 (\$0.015 million in 2004–2005).

CONTRIBUTION TO OUTCOMES

In 2005–2006, the distribution of Information Support Services costs were approximately 50 per cent to Outcome 1 and 50 per cent to Outcome 2. The effectiveness of those contributions is assessed largely from formal and informal parliamentary and audit client feedback and from client demand for these services.

OUTPUT GROUP 3

ASSURANCE AUDIT SERVICES

Assurance Audit Services (AAS) outputs are:

- financial statement audit reports;
- business support process audits;
- protective security audit reports; and
- other attest reports.

The following summarises the ANAO's achievements against those outputs as well as commenting on how the outputs contribute to our outcomes.

FINANCIAL STATEMENT AUDIT REPORTS

The ANAO conducts financial statement audits to express an opinion on whether financial statements of Australian Government entities have been prepared in accordance with the Government's reporting framework and give a true and fair view, in accordance with applicable Accounting Standards and other mandatory financial reporting requirements, of the financial position of each entity as at year end, and the results of the entities' operations and the entities' cash flows for the year then ended.

The Auditor-General delegates signing responsibility for some financial statement audits to senior ANAO staff based on a risk assessment of each audit. In addition to the audit opinion on financial statements, we provide each audited entity with a report that deals with the results of the financial statement audit and an assessment of business or accounting processes. A report on the audit is also provided to the responsible Minister. We also provide two cross-entity assurance reports to the Parliament each year. One details the results of the interim phase of the audit of the financial statements of major entities while the other provides a summary commentary on the results of all financial statement audits undertaken in the 12-month audit cycle ending in December of each year.

FINANCIAL STATEMENT AUDIT – PERIOD ENDED 30 JUNE 2005

In December 2005, Audit Report No 21¹ was tabled that summarised the final result of the audits of the financial statements of Australian Government entities for the period ended 30 June 2005,² including the Consolidated Financial Statements of the Australian Government. A commentary was provided on

¹ Audit Report No.21 2005–2006 *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2005*.

² For the year ending 2005–2006, the audit cycle is completed around the end of the calendar year 2006. This means we can only report the results of 2004–2005 financial audit cycle in this report.

a number of contemporary issues relating to key developments in the financial reporting and auditing framework impacting the Australian Government and its reporting entities. Also outlined were the results of the review of the triple bottom line reports for the Department of Families, Community Services and Indigenous Affairs and the Department of the Environment and Heritage.

There was a reduction in the number of material general Government Sector Entities that provided clearance to the Department of Finance and Administration by the 30 July deadline (76 per cent, down from 88 per cent in 2003–2004). This was largely attributed to difficulties in managing the preparation of the financial statements. To help promote improvement in this process, we published a comprehensive better practice guide on the preparation of financial statements in April 2006.³

The December 2005 report also summarises the final results of the audits of the financial statements, providing details about qualifications of audit opinions and any matters emphasised in audit reports. It also detailed the results of the individual financial statement audits and any additional significant control issues identified by each audit.

The report revealed 18 breaches of the Constitution, largely in relation to reliance placed on ineffective section 31 agreements for the authority to retain and spend revenue from independent sources. Additional statutory disclosures were included in the audit reports of 18 entities, relating to expenditure of receipts generated by entities that had not been properly authorised for spending due to either the ineffectiveness or absence of the necessary instrument (and agreement made under Section 31 of the FMA Act). Further, a breach of section 48 was reported as a result of deficiencies in the accounts and records of the Department of Defence.



ANAO Financial Statement Auditors, from left: Martin Fox, Niti Mehta and Lorena Skipper.

The report also summarised progress and some of the difficulties encountered in the implementation of Australian Equivalents to International Financial Reporting Standards (AEIFRS). The first stage of the process to adopt AEIFRS was for entities to produce and have audited a restated AEIFRS compliant balance sheet; schedules of administered assets and liabilities; and accounting

³ *Preparation of Financial Statements by Public Sector Entities* (April 2006).

policy notes at 1 July 2004. The report highlighted a number of common areas of impact and areas of significant financial impact based on the results of work done by entities. Some of the difficulties encountered by entities during this phase included:

- the allocation of resources to manage the transition to AEIFRS;
- the identification of key changes; and
- management's oversight and involvement in this process.

Australian Accounting Standards also required disclosure in the 2004–2005 financial statements of the effects of the adoption of AEIFRS for the reporting period starting 1 July 2005. We reported that 96 per cent of material general government sector entities complied with this requirement. The report identified some significant adjustments estimated and reported by the Department of Finance and Administration, the Australian Office of Financial Management and Centrelink. We also stated that the Department of Defence had been unable to quantify the impact of transitioning to AEIFRS due to the scale and complexity of the matters involved.

A broad range of internal control issues were raised as part of the final audit phase, all of which were consistent with issues from the interim audit phase and those of previous years. Most were specific to the entity concerned and covered such issues as:

- opportunities for improvement within the financial statement preparation process;
- the need to develop, implement, test and document comprehensive business continuity plans;
- deficiencies in the performance of key reconciliations;
- shortcomings in access security within the HRMIS and the FMIS; and
- deficiencies in the robustness of IT control environments.

INTERIM FINANCIAL STATEMENT AUDIT – PERIOD ENDED 30 JUNE 2006

In June 2006, Audit Report No 48⁴ was tabled which presented the results of the interim phase of the 2005–2006 financial statement audits. The audits encompassed a review of governance arrangements related to entities' financial management responsibilities, and an examination of internal control, including information technology system controls for all portfolio departments and other major General Government Sector (GGS) entities that represent 95 per cent of total GGS revenues and expenses. The reviews are designed to assess the reliance that can be placed on internal controls to prepare complete and accurate information for financial reporting purposes.

⁴ Audit Report No 48 2005–2006 *Interim Report of the Audit of Financial Statements of General Government Sector Entities for the Year Ending 30 June 2006*.

CONTROL ENVIRONMENT

As part of the financial statement audit process, the ANAO assesses whether an entity's internal control environment comprises measures that contribute positively to establishing a foundation for effective internal control, and minimises both financial and non-financial risks to the entity. The measures should be designed to meet the individual circumstances of each entity and to assist in the orderly and efficient conduct of its business in compliance with applicable legislative requirements.

In conducting an audit of an entity's financial statements, we focus on specific elements of the control environment. The main elements reviewed are:

- senior executive group arrangements;
- audit committee arrangements;
- systems of authorisation, recording and procedures; and
- a financial performance management regime.

A large majority of entities have established key elements of control environments which provide a sound basis for effective financial management. In particular, there is an increasing awareness of the importance of audit committees; entities fully understanding their own operations; and the risks in achieving corporate objectives. However, issues associated with legacy systems and the implementation of new systems have also been noted. Some inconsistencies still remain in the application and execution of better practice approaches to compliance with the financial framework and service arrangements between Australian Government bodies.

In assessing entities' risk management processes, we identified some inconsistencies in the application and execution of sound practice in business continuity and fraud control management.

INFORMATION TECHNOLOGY SYSTEMS

The Australian Government has a substantial investment in information technology (IT), with the delivery of many government programs and services critically dependant upon technology. Because of this significance, the ANAO regularly assesses the effectiveness of information system controls supporting the financial statement reporting process. The focus this year was on: IT governance; business continuity management; IT security; and (where applicable) the SAP financial system.⁵ Each of these areas of focus are discussed below.

⁵ SAP is a proprietary financial management information system widely used in the Australian Government Public Sector.

IT GOVERNANCE

IT governance is a well established discipline in the majority of entities, with current practices assisting management to provide direction for the use and alignment of IT and the management of IT risks. Most entities have established IT strategic steering committees and have implemented appropriate structures to facilitate the direction, evaluation and monitoring of IT activities. However, a number of entities have yet to effectively integrate IT risk management processes into their overall corporate risk management framework.

BUSINESS CONTINUITY

The majority of entities have continued to make improvements in their business continuity management practices. Some 75 per cent of entities provide continuity awareness training through staff induction programs and a similar number record and report on incidents that affect the availability of IT systems. However, a significant number of entities have not incorporated technology risk assessment into their continuity frameworks and do not conduct regular and integrated testing of their continuity arrangements. Further, some 40 per cent of entities have yet to fully develop disaster recovery plans for all key business systems and a number have not established processes to regularly monitor and assess the currency and effectiveness of their plans.

IT SECURITY

The majority of entities have also continued to make improvements in their IT security management practices. Some 90 per cent of entities have developed an IT security management framework that is supported by organisational security policies and practices. A similar number of entities regularly conduct formal security awareness briefings and perform intrusion testing. However, a number of entities still have weaknesses in the area of monitoring of access privileges, performing regular assessments of IT security, and implementing incident detection and escalation procedures.

SAP FINANCIAL SYSTEM

The SAP financial system is utilised by many large agencies and is a highly configurable application. Almost all entities have improved application security through restricting access to powerful software that allows system information to be changed and implementing better user access administration, although most entities could strengthen the monitoring of user access. We have observed improved and strengthened system controls for some entities (generally those reported on last year), while others still had poorly configured controls and/or controls not compliant with internal policy and procedures.

We will continue to review IT governance, business continuity and IT security controls given their importance to the availability, confidentiality and integrity of information. The establishment and maintenance of a strong IT control environment assists entities to manage and mitigate the risks associated with the increasing use and dependence on technology. Controls also provide ongoing assurance over the reliability of reported financial information.

CONTROL PROCEDURES

An entity's system of internal control includes the procedures established to provide reasonable assurance that operational and administrative objectives and goals are achieved. Internal controls over significant operational and accounting processes and financial systems are assessed as part of the audit of an entity's financial statements. In most entities, key areas covered in the interim phase of the audit included:

- appropriations management;
- receivables, revenue and receipts;
- cash management;
- purchasing, payables and payments;
- employment and related costs; and
- asset management.



Vandana Singh and Matthew Plum of IT Audit.

Overall, the interim phase of the audit found that the effectiveness of controls over business and accounting processes had generally been maintained at a reasonable level. However, most of the entities had areas that required attention, particularly in relation to reconciliations, revenue and debt management, employment and related entitlements processing, payment processing, asset processing and management and documentation of policies and procedures.

In addition, the large number of control weaknesses relating to IT controls, such as the management of user and systems access, IT security and change controls, indicates that increased management attention is required to provide assurance that entities have appropriate information systems controls in place.

INTERIM AUDIT FINDINGS

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

Overall, the results of the interim audits of entities reviewed during 2005–2006, excluding the Department of Defence (Defence) and the Defence Materiel Organisation (DMO), indicated that the effectiveness of control procedures over business and accounting processes was generally consistent with that found in the previous year. This was demonstrated by the following findings:

- the number of entities with ‘A’ category audit issues in both 2005–2006 and 2004–2005 is three;
- the total number of ‘A’ category audit issues is nine in both 2005–2006 and 2004–2005;
- the number of entities with no category ‘A’ or ‘B’ audit issues was seven in 2005–2006, up from six in 2004–2005;
- the total number of ‘B’ category audit issues across all entities, increased from 59 in 2004–2005 to 67 in 2005–2006, due largely to a small deterioration in performance by a number of entities and the fact that no findings were reported last year for the Department of Human Services as the interim audit was not completed when the report was being prepared; and
- five entities reported an improvement in the number of ‘B’ category audit issues, seven entities showed a deterioration in their position, and eight entities remained in the same position.

Defence and DMO were excluded from the overall analysis of audit activity as their audits were still in progress when the interim report was being prepared. At the time of its publication, the resolution of issues in Defence and DMO remained uncertain. However, a section was included in the interim report which discussed Defence and DMO remediation plans for addressing its numerous systems and financial management issues.

INTERIM AUDIT CONCLUSIONS

The results of the interim phase of the audit for entities covered in the interim report indicated that the effectiveness of control activities over business and accounting processes have generally been maintained at a reasonable level, although the total numbers of moderate audit findings increased in 2005–2006 (excluding Defence and DMO). The audit findings suggested that entities need to pay more attention to the controls underpinning their financial management frameworks, particularly in the areas of business continuity and information systems.

A number of issues, which influence our ability to provide positive assurance about an entity’s internal control environment, were also identified in this year’s interim phase. These issues included:

- shortcomings in the management of compliance with financial legislation;
- issues relating to arrangements for entities to work collaboratively on a whole-of-Government basis;
- the level of integration of risk management with corporate planning and budgeting;

- the level of development of a business continuity framework and implementation of disaster recovery plans and processes;
- weaknesses in fraud control planning and mechanisms;
- concerns over control self assessment practices;
- the adoption of the Australian Equivalent of International Financial Reporting Standards in 2005–2006; and
- other significant issues that are applicable to a number of entities include the complexities inherent in accounting for estimates and the tight reporting deadlines for Australian Government entities.

AUDIT METHODOLOGY

The ANAO continues to utilise a risk based methodology in undertaking our financial statement audits. The methodology emphasises the need for a detailed understanding of the client’s organisation and associated business risks, and seeks to place greater reliance on business processes and management.

As part of our commitment to improved service and enhanced products a new methodology and enabling technology was purchased in 2005–2006. This methodology and enabling technology is currently being utilised on five financial statement audits in a pilot program during the 2005–2006 audit cycle. Upon satisfactory completion of the pilot program, it is proposed that the new methodology and enabling technology will be utilised by all our financial statement audit staff for the 2006–2007 audit cycle. Methodologies utilised by the ANAO are supported by comprehensive training programs.

CLIENT SURVEY

An independent survey was completed in May 2006 to gain feedback from entities on the conduct of the audit of their 2004–2005 financial statements⁶. Of the entities that were included in the survey, 91 responses were received. The survey results received were very positive and indicated a high degree of satisfaction with the performance of the ANAO in auditing entities 2004–2005 financial statements. Key findings included the following:

- 92 per cent of respondents considered that the auditors demonstrated sufficient understanding of the financial reporting requirements of the entity;
- 94 per cent of respondents agreed that the auditor’s interaction with agency staff was conducted in a professional manner; and
- 93 per cent of entities agreed that the ANAO’s financial statement audit services make a valuable contribution to the organisation.

⁶ Due to timing of the financial statement audit cycle, this data relates to the 2004–2005 financial year.

The results of the survey have been discussed with relevant ANAO staff to identify lessons learned so that improvements can continue to be made to future audits. We are continuing to explore avenues to increase entity awareness of the products, publications and services available on financial statement and related assurance matters as a means of improving performance.

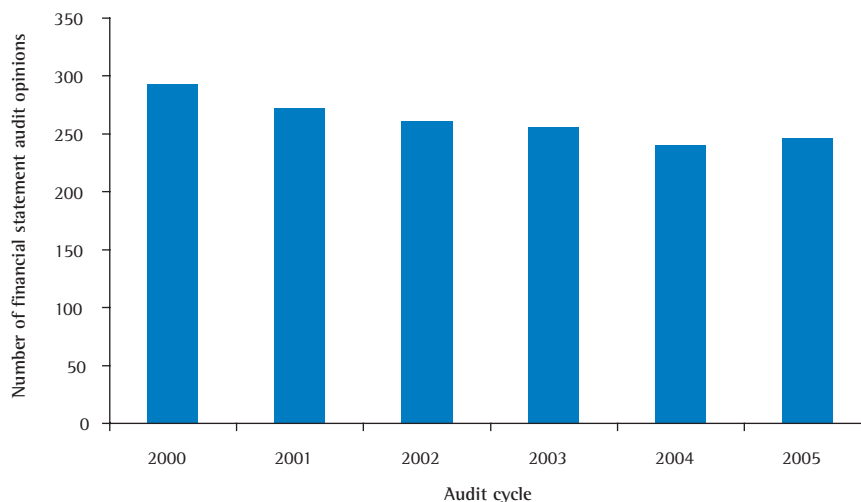
PERFORMANCE

The primary performance measures for financial statement audit reports relate to the number of opinions issued, timeliness and cost. Measures of quality are discussed under ‘Contribution to Outcomes’.

NUMBER AND TYPE OF OPINIONS ISSUED

The number of audit opinions issued for the 2004–2005 financial statement audit cycle, in comparison to previous periods, is illustrated in Figure 6.⁷

FIGURE 6: NUMBER OF OUTPUTS FROM THE FINANCIAL STATEMENT AUDIT PROCESS



During the 2004–2005 audit cycle we issued 246 audit opinions. This compares with 240 opinions in the 2003–2004 audit cycle. Separate reports were also provided to Ministers on the results of all financial statement audits.

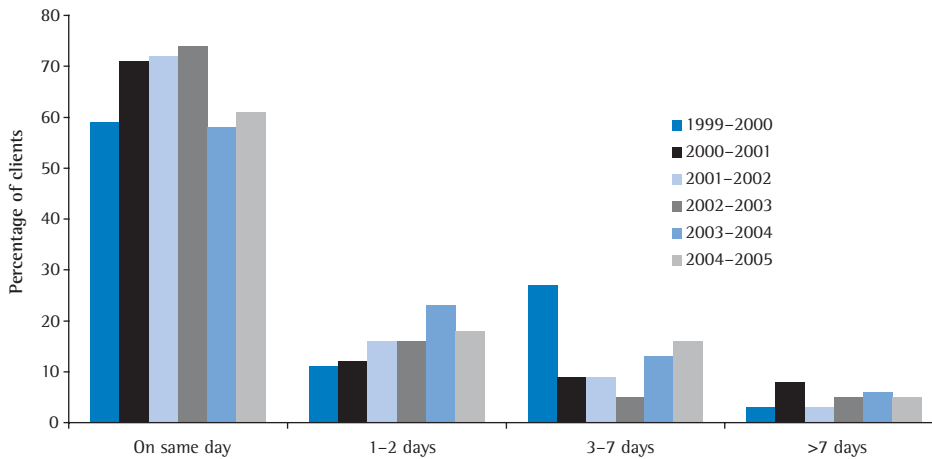
TIMELINESS OF ISSUING OPINIONS

Issuing audit opinions on the day the financial statements are signed, or shortly thereafter, assists agencies in meeting their own management and annual report commitments. For the audit cycle, 79 per cent of opinions were issued on the day the financial statements were signed or within two days, compared to 81 per cent for the previous audit cycle.

⁷ For the year ending 2005–2006, the audit cycle is completed around the end of the calendar year 2006. This means we can only report the results of 2004–2005 financial audit cycle in this report.

The time taken to issue audit opinions after the date of signing the financial statements for the last six years is shown in Figure 7.

FIGURE 7: TIMELINESS OF ISSUING AUDIT OPINIONS



COMPLETION WITHIN AGREED TIMELINES

The ANAO endeavours to complete financial statements audits within agreed timelines.⁸ The Budget Estimates and Framework Review (BEFR) sets delivery targets for entity financial statements. For the 2004–2005 financial year, 76 per cent of material entities were able to provide full audit clearance to the Department of Finance and Administration in accordance with the requirements established under the BEFR. This compared to 73 per cent in 2003–2004.

COST OF FINANCIAL STATEMENT AUDITS

Financial statement audits (Output Group 3.1) for the 2005–2006 financial year required approximately 198 000 hours and consumed \$39.255 million of resources (190 000 hours and \$35.616 million respectively in 2004–2005). The increase in hours required to complete the audits was primarily a result of increased auditing complexities and the introduction of AEIFRS.

COST OF ASSURANCE AUDIT SERVICES

Overall, the Assurance Audit Services Group charged 222 347 hours in 2005–2006, generating \$30.114 million in notional cost recovery and actual revenue against actual costs of \$29.308 million (218 912 hours in 2004–2005 generating \$27.804 million in notional cost recovery and actual revenue against actual costs of \$27.462 million).

⁸ Due to the timing of the financial statement audits cycle, this data relates to the 2004–2005 financial year.

AUDIT FEES

Commonwealth authorities and companies and their subsidiaries that are subject to the *Commonwealth Authorities and Companies Act 1997* are liable to pay fees for the audit of their financial statements. These fees are based on a scale determined by the Auditor-General under section 14 of the *Auditor-General Act 1997*.

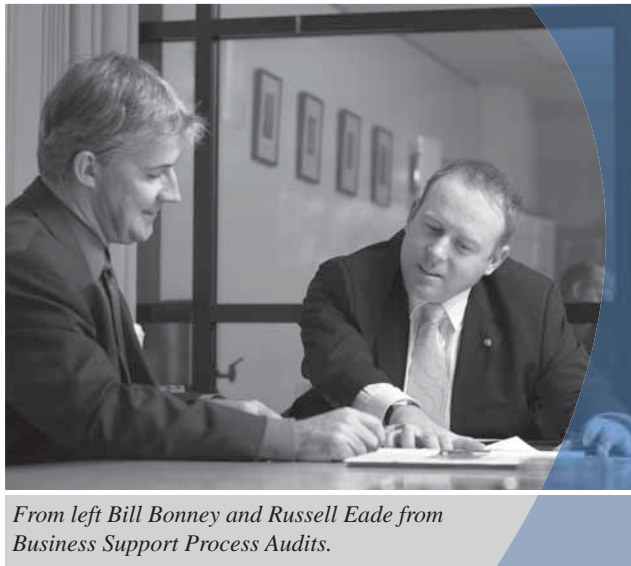
In determining audit fees, we continue to use a system whereby the audit fees charged for financial statement audits are calculated on a cost recovery basis using an accrual-based costing model to determine an hourly charge out rate per level. The costing model takes into account all relevant costs including the attribution of overhead costs. Audit fees were recovered, either notionally or actually, in 2005–2006.⁹

BUSINESS SUPPORT PROCESS (BSP) AUDITS

Business Support Process (BSP) audits examine business processes that support the delivery of outputs provided by public sector entities. In a formal sense, BSPs are performance audits and are normally conducted in a selection of entities, under the provisions of section 18 of the Act. This section provides for the examination of a particular aspect of the operations of the whole or part of the Australian Government sector.

These audits are designed to examine areas and issues that are relevant to all, or a majority of entities. As such, audit findings and recommendations

are usually reported to the Parliament in generic terms, without being attributed to individual entities. In addition to the parliamentary report on each audit, an individual report is provided to the chief executive officer of each of the entities examined in the audit. Output from these audits may also include the development of Better Practice Guides. (See Output Group 2.)



From left Bill Bonney and Russell Eade from Business Support Process Audits.

⁹ Section 14 also requires the Auditor-General to include in the ANAO Annual Report, details of the basis on which the Auditor-General determined the audit fees that applied during the financial year concerned.

PERFORMANCE

The primary performance measures for this output relate to the number of audits completed, timeliness and resource usage.

Measures of quality are discussed under 'Contribution to Outcomes'.

NUMBER OF BSP AUDIT REPORTS

The three BSP audit reports listed below were tabled during 2005–2006 against a target of six reports (the remaining three reports are underway). Each of these reports is summarised in Appendix 4.

- Audit Report No.11 2005–2006 *The Senate Order for Departmental and Agency Contracts (Calendar Year 2004 Compliance)*;
- Audit Report No.16 2005–2006 *The Management and Processing of Leave*; and
- Audit Report No.37 2005–2006 *The Management of Infrastructure Plant and Equipment Asset*.

AVERAGE TIMEFRAMES AND COSTS OF THE TABLED REPORTS

The average time taken to complete the tabled BSP audit reports was 10 months with a range from 8 months to 14 months.

The average cost of the tabled BSP audit reports was \$0.234 million with a range from \$0.203 million to \$0.440 million.

COST OF THE BSP AUDIT PROGRAM

The BSP audit reports output consumed \$1.565 million in resources in 2005–2006 (\$1.507 million in 2004–2005).

PROTECTIVE SECURITY AUDITS

Protective security audits are a separate category of BSP audits and as such are regarded as performance audits. These audits are undertaken under section 18 of the Act. The audits examine particular aspects of security, including information security, personnel security and physical security.

PERFORMANCE

The primary performance measures for this output relate to the number of reports completed, timeliness and cost. Measures of quality are discussed under 'Contribution to Outcomes'.

NUMBER OF PROTECTIVE SECURITY REPORTS

One protective security audit report, Audit Report No.23 2005–2006, *IT Security Management*, was tabled during 2005–2006, against a target of one. The report of the audit is summarised at Appendix 4.

TIMEFRAME AND COST OF THE TABLED REPORT

The length of time taken to complete the tabled report was 15 months at a cost of \$0.333 million.

COST

The protective security audit reports output consumed \$0.070 million in resources in 2005–2006 (\$0.397 million in 2004–2005). The variation in costs reflects the fact that the majority of the costs of the audit tabled in 2005–2006 were incurred in the previous year.

OTHER ATTEST REPORTS

The ANAO also provided assurance services to entities on matters outside the scope of the annual financial statement audit. Entities can request the ANAO to undertake reviews of aspects of their activities on a cost recovery basis and a number of entities, as part of their own corporate governance arrangements, are seeking reviews or audits of their half-year financial statements. In addition, these services included grant acquittal certificates, performance information verification and other special purpose engagements. Of particular interest this year was our verification of the triple bottom line¹⁰ reports for the Department of Families, Community Services and Indigenous Affairs and the Department of the Environment and Heritage.

COST

The cost of the other attest output for 2005–2006 was \$1.681 million (\$1.625 million in 2004–2005).

CONTRIBUTION TO OUTCOME 2—ASSURANCE

Through the conduct of financial statement audits and other attest audits, the ANAO contributes to providing assurance to individual entities, Ministers, the Parliament and the public about the financial administration and accountability of public sector entities.

The main output that contributes to Outcome 2 is the conduct of annual financial statement audits of Australian Government reporting entities, which provide stakeholders with assurance that an entity's financial statements fairly represent its financial operation and its position at year-end.

FINANCIAL STATEMENT AUDIT OPINIONS

Financial statements must be accompanied by an audit opinion pursuant to legislative requirements. The audit opinion issued by the ANAO adds credibility to the financial statements, thereby allowing all Australian Government entities to fulfil their own accountability obligations.

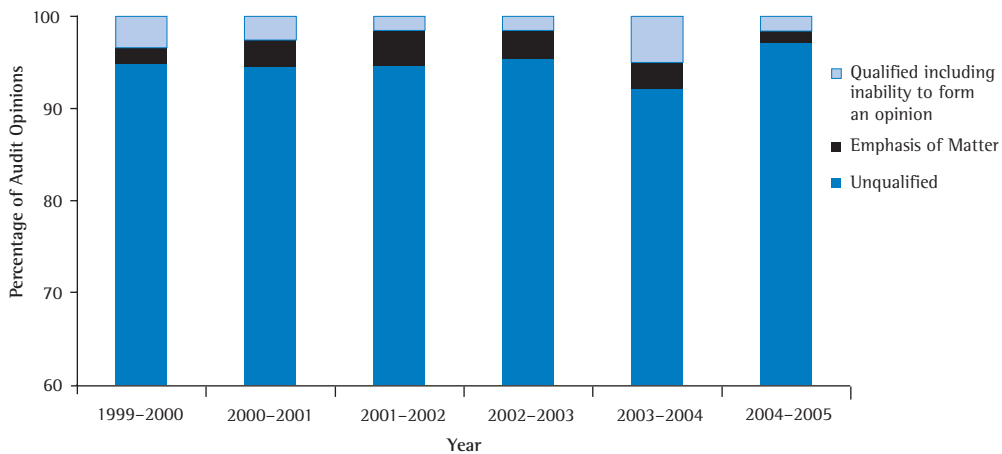
¹⁰ Triple Bottom Line (TBL) focuses on reporting and making decisions explicitly taking into consideration information on economic, environmental and social performance. As such TBL can be seen as both an internal management tool as well as an external reporting framework.

The provision of the audit opinion therefore fulfils an intermediate outcome. The indicators of ANAO effectiveness in relation to audit opinions expressed on financial statement audits are as follows:

- the *nature* of the opinion expressed (that is, unqualified or qualified); and
- the *nature* and *frequency* of audit findings.

The need to *qualify* an audit opinion can arise for a number of reasons outside the control of the ANAO. However, we work closely with agency boards and the management of each entity in an endeavour to eliminate factors that may result in a qualified opinion. The percentage of unqualified audit opinions issued in the current audit cycle was 97 per cent.

FIGURE 8: PERCENTAGE OF UNQUALIFIED OPINIONS¹¹



OTHER ASSURANCE AUDIT REPORTING

The financial statement audit opinions are complemented by the assessments provided in the biannual reports to the Parliament covering the control structures of material reporting entities (June); the financial statements of all reporting entities (December); and the periodic BSP audit reports providing assurance on selected financial and administrative topics. The reporting of protective security audits and conduct of specific-purpose attest audits also contributed to Output 2.

A significant component of the financial statement audits, BSP audits and protective security audits is a report on the outcome of the audits for presentation to audit committees, chief executive officers, boards of management and senior management of agencies. Such reports provide an assessment of the internal controls in operation and make recommendations designed to improve the entity’s control environment. Effective internal controls can significantly lower the risk that the financial statements produced by an entity will contain material errors. It also reduces the risk that business support processes and protective security arrangements will suffer from significant breakdowns.

¹¹ The ‘emphasis of matter’ references are provided in unqualified reports to draw the reader’s attention to important matters that aid understanding of the financial statements.

Where applicable, assurance audit reports provided to individual entities and presented to the Parliament outline recommendations for improvement, which, in the main, are accepted by management of the relevant entities.

The 2005–2006 Interim Phase report discussed earlier in this chapter provides a summary of the financial accounting and information technology control processes adopted by entities. It also includes an update on the broader corporate governance issues that impact on financial management and reporting. In addition, issues affecting our ability to provide positive assurance about an entity’s internal control environment are also addressed in this section.

PARLIAMENTARY INTEREST

The Joint Committee of Public Accounts and Audit (JCPAA) is reviewing Audit Report No. 21 of 2005–2006, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2005*. The JCPAA is also undertaking an inquiry into financial reporting and equipment acquisition at the Department of Defence and the Defence Materiel Organisation. Further, the JCPAA is undertaking a joint review of Audit Report No. 11, *The Senate Order for Departmental and Agency Contracts (Financial Year 2004-2005 Compliance)*; Audit Report No. 27, *Reporting of Expenditure on Consultants*; and Audit Report No. 23, *IT Security Management*. At the time of preparing this report, these inquiries were in progress.

DEVELOPMENTS IN THE AUDITING PROFESSION

Developments, nationally and internationally, designed to improve the quality and comparability of entity financial reports will influence the accounting treatments and disclosures in the financial statements of Australian Government entities for 2005–2006 and subsequent years. Key developments include:

- the adoption of the Australian Equivalent of the International Financial Reporting Standards in 2005–2006;
- the development by the Australian Accounting Standards Board (AASB) of a strategy for addressing public sector accounting issues; and
- the issue of an exposure draft for an accounting standard for financial reporting of general government sectors by governments, involving harmonisation of accounting standards with the requirements of Government Finance Statistics.

In addition, Auditing Standards issued by the Australian Auditing and Assurance Standards Board (AUASB) are being enhanced to improve the quality of auditing through:

- the upgrading of these standards in preparation for making them legally enforceable for the purposes of the *Corporations Act 2001* from 1 July 2006; and
- the continuing harmonisation of these standards with International Standards on Auditing (ISAs).

As a result of previous ANAO audits, JCPAA reviews and efforts by the Department of Finance and Administration (Finance), entities are now including an increased consideration of legal and compliance risks as part of their overall risk management frameworks. To reinforce this current commitment to legislative compliance, Finance has implemented a requirement for the 2006–2007 year, for the Chief Executives (CEs) of all FMA agencies to sign an annual Certificate of Compliance. The Certificate requires agencies to focus on its existing responsibilities under the FMA Act and satisfy itself and its responsible Minister that these responsibilities have been discharged.

QUALITY ASSURANCE

In 2005–2006 the Research and Development Branch quality assurance review program included a selection of:

- 2004–2005 financial statements audits;
- the planning phase, of a selection of 2005–2006 financial statement audits; and
- AEIFRS opening balance audits.

The main areas highlighted by the review that required attention were related to the planning and aligning of resources to audits. The results of these reviews are provided to the Executive Board of Management and action is underway to respond to the results of the review program.