

Auditor-General of Queensland

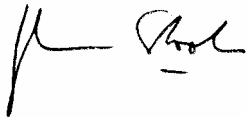
19 July 2006

The Honourable the Speaker
of the Legislative Assembly of Queensland

Dear Mr Speaker

This Report, prepared under Part 6 Division 3 of the *Financial Administration and Audit Act 1977*, on the results of audits completed at 31 May 2006 including universities and grammar schools, is the fourth in the series of the Auditor-General's Reports to Parliament for 2006.

In accordance with s.105 of the Act, would you please arrange for the Report to be tabled in the Legislative Assembly.



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Auditor-General



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Section 1

Executive summary

1.1 Auditor-General's overview

This Report deals specifically with the results of the 2005 financial year audits of universities and grammar schools, the progressive results of other audits completed and emerging issues.

The universities and grammar schools were among the first public sector entities to prepare financial statements using the Australian equivalent to International Financial Reporting Standards (AeIFRS). The majority of the entities in this sector were well prepared for audit. This provides some comfort that the transition to the AeIFRS framework across the public sector should be achieved without a significant level of difficulty.

Governance and accountability have been ongoing themes in my Reports to date, one recent example being the examination conducted of the financial management of Aboriginal Shire Councils and Torres Strait Island Councils included in my Report No. 3 for 2006.

In this Report, I have taken the opportunity to examine a number of issues including the project governance of the Brisbane City Council payroll system and the tender process for the Caboolture Emergency Department where concern has been expressed about the procedures which have been followed. Following a review of these issues I am able to provide clarification on the robustness of the processes to Parliament.

Apart from issues involving particular public sector entities, I have also examined the results of QAO's 2005-06 interim audits to see if there are any systemic issues which the sector as a whole needs to consider to improve governance and accountability. The review of controls over electronic funds transfer similarly has involved examining a number of public sector entities and as a result, incorporates two case studies where controls have failed. These case studies may assist entities to recognise potential problem areas in their own systems.

As this report covers the results of the audits of universities, I would like to disclose that I am currently a member of the Centre of Philanthropy and Nonprofit Studies Advisory Board at the Queensland University of Technology. The Board reviews the goals and policy of the Centre and provides a means of accountability to its stakeholders and the community. It is not involved in the Centre's financial management. I do not receive any remuneration for this role.

1.2 Matters of significance

1.2.1 Section 2 — Results of 2005 university and grammar school audits

The financial year for universities and grammar schools being reported upon is 31 December 2005.

All university audits have been completed for 2005 and unqualified independent audit reports were issued on the financial reports of all of them.

In 2005, modified audit opinions were issued on the financial statements of 19 of the 26 trading entities controlled by The University of Queensland. Generally, the underlying cause of the modified audit opinion was due to the inherent uncertainty of the ability of these entities to continue as going concerns.

The financial reports of three public sector entities associated with the universities which are controlled by more than one public sector entity also received modified audit opinions due to the inherent uncertainty about whether these companies could continue as going concerns.

1.2.2 Section 3 — Other audit results

Brisbane City Council payroll system – Review of project governance

In my Report No. 4 for 2005, I provided a preliminary overview of the various issues surrounding Brisbane City Council's new payroll system, which went live on 27 June 2005. A review of the Council's implementation of the new payroll system has been completed against three essential components for ensuring effective accountability and responsibility for significant IT projects, being program oversight at a corporate level, a robust project management framework and a proven project methodology. The results of this review are included in Section 3.1.

Department of Employment and Training (DET) – Review of TAFE student enrolment information

As student enrolments information forms the basis for the majority of activities undertaken by DET funded Registered Training Organisations, incorporating TAFE Institutes, I determined that the financial and compliance audit of DET should be expanded to incorporate a review of the frameworks and systems in place to support the effective management and accurate recording of student enrolment and outcome information. The results of this review are included in Section 3.2.

Department of Health – Review of Caboolture Emergency Department tender process

From late December 2005 Queensland Health experienced staffing difficulties at a number of hospitals which included maintaining a full service Emergency Department at the Caboolture Hospital. The Department determined that the emerging situation of the Caboolture Emergency Department was a high priority issue that required urgent action. This led to a number of decisions being made in a high pressure environment under very tight timeframes about options to maintain the services provided at the Caboolture Emergency Department. The responsibility for the various procedures associated with the process to acquire external advice and the supply of services was therefore shared across operational and administrative lines. Ordinarily these processes would be led by the Department's purchasing section, Health Services Purchasing and Logistics.

The audit has not identified any evidence of officers not conducting themselves in good faith in completing the tender process. The primary finding of this report relates to an inadequate level of documentation to evidence/substantiate the tender and contract allocation processes. The detailed review outcomes and recommendations are included in Section 3.3.

Interim audit issues

The 2005-06 interim audit phase where auditors test the controls implemented by management identified a number of common themes and issues affecting agencies' systems of internal control. The matters reported did not apply to all agencies but were common enough to suggest the need for attention from a broader public sector perspective. Agencies where these issues have been raised during the interim audit phase have been encouraged to take any necessary action to address the issues identified before the audits for 2005-06 are finalised. An analysis of the issues is contained in Section 3.6.

Controls over electronic funds transfer (EFT)

Following a review of EFT using desktop banking systems conducted at 10 entities in 2004, it was decided to expand this review to cover a broader range of public sector entities. This expanded review yielded similar results to the 2004 audit. It was found that there were varying standards of controls in place over EFT and in general, desktop banking systems appeared to have been treated as an addition to, rather than being integrated with the operating and control environment of traditional financial systems. Two case studies have been included in Section 3.7 as part of the findings which highlight the need to maintain strong controls over EFT systems.

Section 2

Results of 2005 university and grammar school audits

2.1 Results of 2005 audits of universities

2.1.1 Introduction

Seven universities are constituted within the Queensland public sector —

- Central Queensland University (CQU);
- Griffith University (GU);
- James Cook University (JCU);
- Queensland University of Technology (QUT);
- The University of Queensland (UQ);
- University of Southern Queensland (USQ); and
- University of the Sunshine Coast (USC).

Each university is governed by its own enabling Act.

The universities are statutory bodies that observe the requirements of the *Financial Administration and Audit Act 1977* and are subject to audit by the Auditor-General. The universities prepare general purpose financial statements in accordance with the Australian Accounting Standards. Additional disclosure requirements are prescribed by the Commonwealth Department of Education, Science and Training (DEST).

Each university prepares an annual report that includes a copy of its audited financial report and a commentary on its financial operations. The annual report is tabled in the Legislative Assembly by the Minister for Education and the Arts.

In this Report, a reference to 'universities' means Queensland public universities, unless specifically stated otherwise.

2.1.2 Results of 2005 audits

All university audits have been completed for 2005 and unqualified independent audit reports were issued on all of the financial reports.

Comments on the audit results of the universities' controlled entities are included in Section 2.1.4 of this Report.

QAO staff and contract auditors provide advice to clients on a wide range of financial and compliance issues and system and procedural improvement opportunities. In 2005, this advice related mainly to the application of the Australian equivalent to International Financial Reporting Standards (AeIFRS) and the State Government's changes to asset accounting requirements.

Financial reporting under Australian equivalent to International Financial Reporting Standards (AeIFRS)

Universities were among the first public sector entities to prepare their 2005 financial reports using the AeIFRS. The majority of universities were well prepared for audit, in spite of the fact that a number of accounting standards had not been formally approved by the accounting bodies until part way through 2005.

Where difficulties were experienced, the underlying causes were due to poor planning, a rushed or ill-considered implementation or loss of knowledgeable accounting staff part way through the implementation.

Audited financial data

The key audited financial data for each university is shown in Table 2.1. The 2004 comparatives for each university have been altered from the published figures to reflect the application of AelFRS and the legislative change that introduced new university funding arrangements.

Table 2.1 — Comparative financial data

	CQU		GU		JCU		QUT	
	2005	2004	2005	2004	2005	2004	2005	2004
Key financial data								
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
Revenue from continuing operations ^a	289	241	432	382	210	199	476	453
Operating results from continuing operations ^a	32	19	20	10	5	4	45	50
Net assets	228	195	837	767	499	440	793	703

^a Restated figures for 2004 shown due to legislative changes made by the Commonwealth Government and the implementation of AelFRS.

Source: University's audited financial statements included in its annual report.

Table — Comparative financial data (continued)

	UQ		USQ		USC		ALL	
	2005	2004	2005	2004	2005	2004	2005	2004
Key financial data								
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
Revenue from continuing operations ^a	865	761	153	131	51	43 ^b	2,476	2,210
Operating results from continuing operations ^a	56	13	18	1	2	1	177	98
Net assets	1,650	1,289	234	191	91	65	4332	3,649

^a Restated figures for 2004 shown due to legislative changes made by the Commonwealth Government and the implementation of AelFRS.

^b Includes a \$2m advance from the Commonwealth Government.

Source: University's audited financial statements included in its annual report.

Diversity of revenue

DEST monitors the financial and business performance of universities across Australia and requires universities to provide certain data to allow this monitoring activity to occur.

One DEST benchmark deals with the diversity of revenue and suggests that to reduce financial risk from a reduction or failure of an income source, universities should develop at least three main sources of revenue.

The majority of the universities are dependent on Commonwealth Government financial assistance as their principal funding source. Table 2.2 shows the extent to which the universities have diversified their revenue sources in the 2005 and 2004 years.

Table 2.2 — Diversity of revenue

Revenue Source	CQU		GU		JCU		QUT	
	2005	2004	2005	2004	2005	2004	2005	2004
	% of total revenue	% of total revenue	% of total revenue	% of total revenue	% of total revenue	% of total revenue	% of total revenue	% of total revenue
Commonwealth government financial assistance	35	37	56	57	69	69	60	60
Fees and charges	55	48	28	28	15	15	19	21
Investment income	2	1	1	1	2	1	6	5
Consultancies and contracts	2	2	5	6	7	7	3	3
State and local government financial assistance	*	1	1	1	1	1	1	2
Other revenue ^a	6	11	9	8	6	6	11	14

^a Other revenue includes royalties, trademarks and licences, sales, HEC-HELP Student Payments and miscellaneous revenue.

* Denotes Revenue is less than 0.5% of total revenue.

Source: University's audited financial statements included in its annual report.

Table — Diversity of revenue (continued)

Revenue Source	UQ		USQ		USC		Sector Total	
	2005	2004	2005	2004	2005	2004	2005	2004
	% of total revenue	% of total revenue	% of total revenue	% of total revenue	% of total revenue	% of total revenue	% of total revenue	
Commonwealth government financial assistance	55	57	66	64	72	71	56	56
Fees and charges	17	17	21	22	17	19	24	23
Investment income	3	1	1	1	1	1	3	2
Consultancies and contracts	6	5	1	1	2	2	5	4
State and local government financial assistance	3	3	1	1	*	*	1	2
Other revenue	17	16	10	12	8	9	11	12

^a Other revenue includes royalties, trademarks and licences, sales, HEC-HELP Student Payments and miscellaneous revenue.

* Denotes Revenue is less than 0.5% of total revenue.

Source: University's audited financial statements included in its annual report.

Fees paid by overseas students

Table 2.3 below shows a comparison of fees paid by overseas students as a percentage of the total revenue. While the revenue from overseas students has increased for universities as a whole, this source of revenue for five of the seven universities has remained reasonably consistent with the prior year.

Table 2.3 — Overseas student numbers and associated revenue

University	2005		2004		2003	
	Overseas student numbers as % of total students	Fees paid by overseas students as % of revenue from continuing operations	Overseas student numbers as % of total students	Fees paid by overseas students as % of revenue from continuing operations	Overseas student numbers as % of total students	Fees paid by overseas students as % of revenue from continuing operations
CQU	n/a	46	43	39	40	38
GU	n/a	20	19	19	17	17
JCU	n/a	8	11	8	10	8
QUT	n/a	15	13	16	13	16
UQ	n/a	12	15	12	14	10
USQ	n/a	16	30	16	28	15
USC	n/a	12	14	14	10	10
ALL	n/a	18	20	17	19	15

n/a = At the time of preparing this report student numbers were not available.

Fees and charges were extracted from the Universities' audited financial statements.

Source: Student Numbers from the Department of Education, Office of Higher Education, (Table 28 Selected Higher Education Statistics, Students 2004 and 2003 (First Half Year),- published by the Commonwealth Department of Education, Science and Training, April 2005).

As competition among Australian and foreign providers of higher education grows, the governing bodies of the Queensland universities need to identify the financial risk to their business should this source of revenue become threatened. In other jurisdictions, universities have incurred financial losses from their transnational activities (i.e. programs or courses delivered and assessed off-shore). Therefore, universities' governing bodies are encouraged to regularly review and update potential financial risks arising from this aspect of their businesses and to document these in their risk management plans.

Another risk from this aspect of the business is the potential loss of a University's reputation should it be unable to prove that it has assurance programs to safeguard the quality of the awards it issues. All Queensland universities are party to or have access to publications issued by the Australian Vice-Chancellors' Committee and the Commonwealth Government which are aimed at assuring the integrity of Australian higher education standards. These documents provide guidance on marketing, recruitment, reception, program or course delivery and assessment and welfare of overseas students.

The importance of maintaining the reputation of the Australian Higher Education System has also been recognised and supported by the Ministerial Council on Education, Employment, Training and Youth Affairs. In November 2005, Ministers for Education and Training across Australia, endorsed the Transnational Quality Strategy and agreed to a new framework for the Education Services for Overseas Students National Code. These initiatives are designed to protect and promote the quality of Australian higher education services whether delivered to students in Australia or in other countries.

The Australian Universities Quality Agency (AUQA) audits each university to verify that quality assurance arrangements are maintained.

During the 2006 audits of universities my staff will be assessing the risk management and treatment plans that have been put in place in respect of transnational activities.

2.1.3 Emerging issues — Continuing reform of the university sector

As stated in Report No. 2 for 2005 on the university sector, the roles of the governing bodies and vice-chancellors continues to grow in complexity. In 2005 the universities were required to implement certain Commonwealth reforms to maximise their 2006 funding. Universities are eligible for an increase of five per cent in the base 2006 Commonwealth Grant Scheme for meeting the National Governance Protocol (NGP) and for complying with Higher Education Workplace Relations Requirements (HEWRRs).

For the 2006 grant year, universities were able to demonstrate to DEST that they have complied with the NGP and HEWRR by the deadline prescribed in the *Commonwealth Grant Scheme Guidelines*.

National governance protocols

DEST set 11 NGP that universities must satisfy each year. The protocols are described in full in the *Guidelines for Commonwealth Grant Scheme* issued under the *Higher Education Support Act 2003*. Included in the protocols are requirements for strengthening procedures over —

- planning, monitoring and assessing performance at various levels within the university;
- establishing and maintaining the knowledge and expertise of the governing body members in the university's business;
- reporting on risk management within the university; and
- establishing stronger control over controlled and associated entities (see Section 2.1.4 for further discussion on governance over controlled and associated entities).

In auditing the universities' accounts for 2006 I will be reviewing the documentation adopted by the universities for these procedures, particularly in the risk management area.

Higher Education Workplace Relations Reform

HEWRRs require universities to —

- negotiate Australian Workplace Agreements for all employees, except casuals employed for less than one month;
- consult directly with employees;
- agree to mutually beneficial working arrangements;
- support organisation productivity and performance; and
- neither encourage nor discourage union membership.

Under the Commonwealth Grants Scheme Guidelines, DEST has the responsibility for auditing compliance with HEWRRs.

2.1.4 Controlled entities of universities

Background

Under their constituting legislation, all universities are empowered to form or participate in ventures that may further the educational objectives of the university. These include companies formed for fundraising and commercialisation of technology developed by each university.

Results of 2005 audits

In 2005 the entities controlled by universities generated revenue totalling \$176m, held net assets totalling \$48m and earned a total profit of \$11m. A summary of the financial results for each university's controlled entities has been included in Table 2.4.

Like other universities, The University of Queensland establishes controlled entities to facilitate the commercialisation of research and development. By their nature, these companies may generate losses for a period of time until the research and development activity results in commercial products that can be licensed, sold or a decision taken to cease activities. Modified audit opinions were issued on the financial statements of 19 of the 26 trading entities controlled by The University of Queensland. As shown in Table 2.5, the modified audit opinions drew attention to the inherent uncertainty about whether the entity could continue to operate as a going concern and/or the inherent uncertainty about how the entity had valued certain intellectual property assets. The opinion on one entity drew attention to both the inherent uncertainty about going concern and asset valuations. In all cases the entity management had included information about the issue(s) in the notes to the financial statements.

The financial reports of three public sector entities associated with the universities which are controlled by more than one public sector entity also received modified audit opinions due to the inherent uncertainty about whether these companies could continue as going concerns.

Table 2.4 — Summary of the 2005 financial information for entities controlled by universities during 2005

Controlling university	Number of entities		Number of modified audit opinions ^a	Summary of financial data		
	Trading	Non-trading		Revenue from continuing operations \$M	Operating result ^b \$M	Net assets \$M
CQU	4	3	0	83	9	8
GU	0	1	0	0	0	0
JCU	6	2	0	6	<1>	<2>
QUT	2	3	0	1	<*>	*
UQ ^{c,d,e}	26	11	19	85	3	42
USQ	0	2	0	0	0	0
USC	1	0	0	1	*	*
Entities controlled by more than one public sector entity ^f	8	2	3			
All	47	24	22	176	11	48

* Amount less than \$500,000.

a A summary of the modified audit opinions and Universities' comments is provided in Table 2.5.

b < > denotes an operating loss from continuing activities.

c This financial data includes the consolidated results of the UQ Holdings Pty Ltd and Comquest Pty Ltd. These two companies are the holding companies of the controlled entities of The University of Queensland. All intra-group transactions have been eliminated.

d 20 matters underpinning the modified audit opinions for 19 companies with Thrombostat Pty Ltd receiving a modified audit opinion for two different matters – Refer Table 2.5.

e During 2005, the University deregistered four companies and established seven new companies.

f These entities have been included due to their association with the universities. These entities are subject to audit by the Auditor-General.

Table 2.5 — Details of modified audit opinions

Controlling university/entity	Management response
Inherent uncertainty regarding continuation as a going concern	
<p>The University of Queensland Activetorque Pty Ltd Antepodi Technologies Pty Ltd Bireme Pty Ltd Combinomics Pty Ltd Comquest No. 1 Pty Ltd Cyclagen Pty Ltd Dendright Pty Ltd Diabax Pty Ltd First Investor Pty Ltd Herdvac Pty Ltd Hydrexia Pty Ltd Kalthera Pty Ltd Lucia Publishing Systems Pty Ltd Neurotide Pty Ltd Thrombostat Pty Ltd Vacquel Pty Ltd Vascam Pty Ltd Wave Instruments Pty Ltd Xerocoat Pty Ltd</p>	<p>The University of Queensland's response The Secretary and Registrar advised — <i>All of these companies are at a very early stage in the commercialisation cycle. Value is usually established only after arms length investment by an external investor.</i> <i>The performance of all the companies is closely monitored by their own management and boards, and those of the parent entity, to ensure that the research and development is proceeding to plan and that they remain solvent. There is no sales revenue as yet, since the end products are still under development.</i></p>
Controlled by more than one public sector entity	
Adipogen Pty Ltd	No additional comment was provided by the company, as the matter was adequately dealt with in its financial statements.
ElaCor Pty Ltd	<p>ElaCor's response <i>ElaCor's business is to develop new commercial biotechnologies and to attract third-party investment in their further development, application, and eventual sale. By their very nature, these type of companies require the support of their shareholders until such time as the technology development has reached a level where third-party risk capital can be secured. ElaCor's technology is rapidly reaching that stage, the parent entities will either continue to provide investment funds to support ElaCor, or, in the event that the technology development program does not attract third party risk capital, will seek to wind-up the company.</i></p>
RRC Company Pty Ltd	<p>RRC's response <i>RRC Company is a non-operating corporate trustee. It does not trade save to distribute eventual benefits to designated inventors from the Renal Regeneration Consortium upon the achievement of commercial milestones.</i></p>
Inherent uncertainty regarding the valuation of intellectual property disclosed in the financial statements	
<p>The University of Queensland Thrombostat Pty Ltd</p>	<p>Uniquet's (parent entity) response <i>We recognise that there is inherent uncertainty in its valuation.</i></p>

Offshore activities

Three universities each controlled an entity incorporated offshore, as shown in Table 2.6. As the ultimate parents of these companies, the university governing bodies are encouraged to instil a strong governance culture, both at the university and the entity, so as to effectively monitor overall performance and to manage the universities' risk exposure.

In addition to controlled entities, the universities also use joint venture arrangements (on and offshore) and co-operative research centres (usually Australian based) as a means to advance educational services, attract research moneys and increase returns on intellectual property.

Table 2.6 — Controlled entities incorporated offshore

University (ultimate parent)	Controlled entity	Country of incorporation	Status
JCU	JCU Singapore Pte Ltd	Singapore	Trading
UQ	CiTR Incorporated	USA	Non-trading
USQ	University of Southern Queensland (South Africa) Pty Ltd	South Africa	Non-trading

Audit results

External audits were conducted of JCU Singapore Pte Ltd and CiTR Incorporated by local accounting firms appointed by the companies. An unqualified independent audit report was provided on the financial report of JCU Singapore Pte Ltd. The financial report covered the period 1 April 2005 to 31 December 2005.

While CiTR Incorporated did not trade, minor administrative costs were incurred. An external audit was conducted of these expenses. An unqualified independent audit report was provided on the financial report on 3 February 2006.

As University of Southern Queensland (South Africa) Pty Ltd is a holding company that did not trade, no external audit was conducted.

Controlled entities — governance requirements

In Report No. 2 for 2005 on Universities, a commentary was provided on the governance of universities' controlled entities. Of particular interest are protocols 10 and 11 of the NGP, which deal with the governance arrangements over entities controlled by, or associated with, universities.

Universities will be penalised through the Commonwealth Grants Scheme, if they cannot demonstrate, that the Board of a controlled entity —

- possesses the skills, knowledge and experience to exercise proper stewardship and control of the entity;
- adopts and regularly evaluates a written statement of its own governance principles;
- annually documents a clear business strategy that includes the entity's long-term objectives as well as achievable and measurable performance targets and milestones; and
- establishes and documents clear reporting lines to the university's governing body, covering approval of its draft business plans prior to the start of the financial year, and at least quarterly reporting against that business plan.

The NGP also requires universities to assess the risk arising from its part ownership of any entity, or participation in any partnership or joint venture. Where a financial risk is identified, the university must endeavour to obtain the entity's audited financial report.

Each university was required to provide documentary evidence of compliance with the NPGs 10 and 11. DEST has accepted that the universities have appropriate governance arrangements in place for the 2006 year. In auditing the universities accounts for 2006 I will review the documentation and reporting mechanisms.

2.2 Results of 2005 audits — grammar schools

2.2.1 Background

Eight public grammar schools are established in Queensland and are located in Brisbane, Ipswich, Toowoomba, Rockhampton and Townsville.

While historically associated with the public sector through the provisions of the *Grammar Schools Act 1975*, the schools operate on a fully commercial basis with only limited financial benefit being derived from their status as public sector entities.

2.2.2 Overview of financial results for 2005

Table 2.7 below provides a summary of key financial information for each school. Table 2.7 shows that sector-wide there was an overall increase in the total operating result from \$11,310,000 in 2004 to \$12,103,000 in 2005. This can be attributed primarily to an overall increase in grant funding and tuition fees offset by a decrease in property development revenue for the Ipswich Boys Grammar School Centenary Building Fund and asset impairment write downs at the Ipswich Girls Grammar School.

Table 2.7 — Key financial information

School	2005			2004
	Revenue from ordinary activities	Net assets	Operating result	Operating result
	\$'000	\$'000	\$'000	\$'000
Brisbane Grammar School	25,260	47,502	1,801	999
Brisbane Girls Grammar School	19,331	36,786	2,451	1,215
Ipswich Grammar School	11,496	36,440	240	(283) [#]
Ipswich Boys Grammar School Centenary Building Fund*	3,619	15,387	2,284	4,532
Ipswich Girls Grammar School	11,412	39,992	(726) [#]	82
Rockhampton Grammar School	16,474	40,698	2,176	1,514
Rockhampton Girls Grammar School	4,656	19,013	114	(62) [#]
Toowoomba Grammar School	14,841	54,882	1,610	1,267
Townsville Grammar School	16,191	15,806	2,153	2,046
Total of Grammar Schools	123,280	306,506	12,103	11,310

*Controlled entity of the Ipswich Grammar School.

Denotes an operating loss.

2.2.3 Results of audits for 2005

The financial statements for all grammar schools received unqualified audit opinions. The audit opinion on the financial statements of the Brisbane Grammar School was modified because the prescribed reporting deadline of 31 March 2006 was not achieved.

The adoption of the Australian equivalent to International Financial Reporting Standards had relatively minimal impact on the grammar schools.

Section 3

Other audit results

3.1 Brisbane City Council payroll system — review of project governance

3.1.1 Background

In my Report No. 4 for 2005, I provided a preliminary overview of the various issues surrounding Brisbane City Council's new payroll system, which went live on 27 June 2005. The main impact of these issues was that an unacceptable high number of incorrect pays occurred over several pay periods, for example some 1,000 incorrect pays occurred in the first pay cycle. Management's remedial action included strategies for resolving identified issues and improving the performance of the payroll system and associated processes and procedures.

In Report No. 4, I reported that the decision to go-live from the beginning of the 2005-06 financial year was taken in light of incomplete user acceptance testing and the knowledge that risks remained regarding accurate and timely transaction processing. The original planned go-live date of 2 August 2004 was not achieved and nor were two subsequent go-live dates. The subsequent volume of payroll related issues once the system was operational overwhelmed the capacity of Council to effectively deal with them in a timely manner. Primarily for these reasons I advised in Report No. 4 that I would undertake a review of the project management and governance arrangements around the payroll implementation. The findings of this review follow.

Report No. 4 also outlined the various payroll issues including incorrect pays, deficiencies in controls and processes and system security and access control concerns. On finalisation of the 2005-06 audit, I will further report on the effectiveness of Council's action in resolving these issues.

3.1.2 Best practice project governance

In my Report No. 1 for 2006 which reviewed IT project governance for significant business systems within the public sector, I outlined three essential components for ensuring effective accountability and responsibility for significant IT projects —

- program oversight at a corporate level including the review and approval of an organisation's portfolio of projects to ensure alignment of activities with business goals, cost control and providing value;
- robust project management framework and skills to ensure that each individual facet of the project is delivered on time, within budget, and with sufficient quality; and
- proven project methodology providing a structure to guide the project team through the completion of all tasks throughout the various stages of the project.

A review of the Council's implementation of the new payroll system was completed against these three essential components.

Program oversight

Council finalised a HR and Payroll Information Systems business case review in January 2001 which presented a comprehensive business strategy and detailed analysis supporting a replacement payroll system. This business case review was undertaken because of concerns regarding continued vendor support for the existing payroll system and the system was considered “expensive to maintain, was not user friendly and was not able to support the Council’s current or future human resource management facilities”.

Once management supported the purchase and implementation of a replacement payroll system, a detailed business benefits case (January 2002), request for tender and subsequent evaluation (January 2003) and the solution purchase (May 2003) followed. Thereafter, project management plans were prepared to manage the project implementation.

QAO’s assessment is that the business case proposal was thorough and was appropriately considered at a senior corporate level. However, certain assumptions and expectations detailed in the business case including the anticipated costs, development and implementation duration and minimal software customisation were not realised.

Project management

Council implemented an effective project management framework at the commencement of the project. Detailed project management and implementation plans outlining the project management approach, scope, project deliverables and milestones, risk management, cost and organisational change management were prepared. Additionally three different project groups with responsibilities for development, testing and implementation of the new system were established to monitor this process and to make the final recommendation to go-live. A Steering Group had key project governance oversight responsibility and made the final recommendation for go-live.

QAO’s review determined that the structure of the Steering Group was appropriate. This included the processes put in place for monitoring project milestones and formal acceptance of the project deliverables accorded with those expected for projects of the scale of the payroll system.

A risk management framework was established to identify and manage potential risks and issues to minimise the impact on project quality, deliverables, cost and scope. However the payroll issues that have arisen and Council’s subsequent investigations seem to indicate a breakdown in the monitoring and control process in respect of project quality and inadequate identification or management of the critical risks and issues. A post-implementation Council review of the reason why earlier planned go-live dates were not achieved identified that there had been an underestimation of the scope of the work and a lack of understanding of the issues, challenges and workloads. Considerably more resources were applied from around October 2004 to address these concerns.

A contributing factor to the delays was that the replacement payroll system required significant configuration and customisation to suit Council’s complex payroll environment and size with some 7,900 staff. As a result of the project delays the original budget for phase 1 of the project of \$11m increased to \$13.9m by the go-live date.

The budget to 30 June 2006 for phase 1 has escalated to \$21.7m. Phase 1 is expected to be completed by December 2006 and total expenditure is expected to reach \$25m. This significant increase in anticipated costs raises the question of whether Council would have approved the replacement payroll system had it known the actual final cost.

In a review by the Public Accounts Committee (refer section below), the Council Chief Executive Officer acknowledged that the original budget was underestimated and “the budget would have been significantly higher if Council had understood the complexity of the business processes, the wide variety of payroll divergences and the necessary change management processes to give more staff access to the system”.

Project methodology

Council had implemented an effective project structure to drive the project including defined responsibilities for the project groups and project leaders, adequate change, issue and risk management processes and communication strategies.

Essentially the Steering Group also established a final review process to assess the readiness of the replacement payroll system for go-live. This comprised a nine point decision criteria in determining whether to proceed with “go-live” on 27 June 2005.

This assessment was made on 23 June 2005 and is detailed in Table 3.1.

Table 3.1 — Decision criteria

Question	Steering group findings
Is the system implementation i.e. full functionality, available?	Yes
Can the production system be implemented and supported?	Yes
Will it handle all the transaction volume?	Yes
Will the database be 100% correct (at least payroll data) as a result of conversion?	Yes
Will the system pay everyone accurately?	Not yet
Will it accurately calculate all the accounting transactions?	Not yet
Will it create all the necessary transactions for all the interfaces in the correct format?	Yes
Will the receiving systems be able to accept all of the transactions i.e. read and process the data accurately and handle the volumes?	Not yet
Are payroll confident they can perform their role?	Not yet

In recommending that go-live proceed, the Steering Group was aware that there were remaining risks regarding the readiness of the system but were of the view that risk mitigation strategies could be implemented and managed. The Steering Group minutes indicated that “...a change in the go-live date now would not be good”. The decision to go-live on 27 June 2005 appears to have been influenced by a perception by the Steering Group of corporate expectations.

Council’s Assurance and Audit Services (internal audit) was involved as an observer throughout different stages of the project. Their Project Status Report dated 23 June 2005 concluded that “...testing will continue after initial implementation due to time constraints and consequently the system may go-live with previously unknown defects. A major area of ongoing concern will be system security and access control...”.

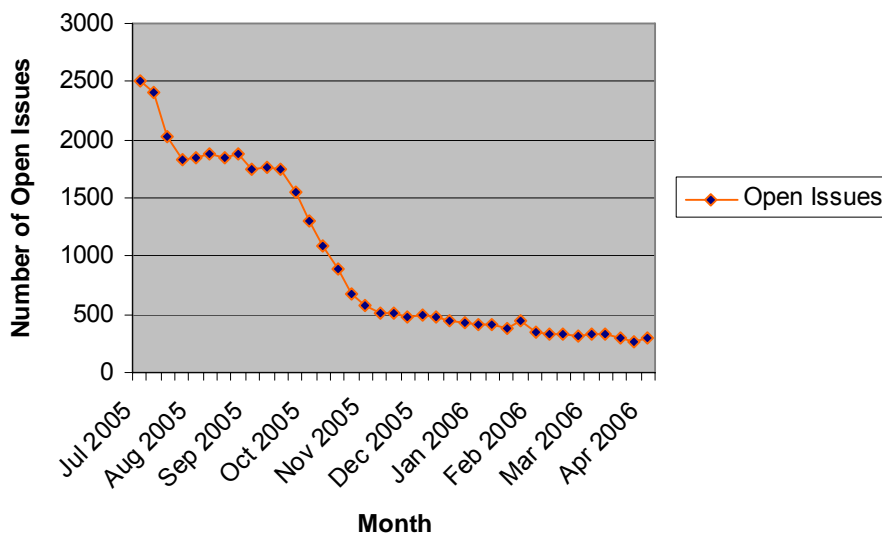
The significant number of payroll issues that occurred post go-live indicates that the Steering Group in recommending go-live underestimated the impact of their findings on project implementation readiness.

Post Go-Live

Since go-live, Council has continued with a project structure to finalise phase 1 to achieve full payroll functionality, to address known risks and issues and to enhance business processes to realise a stable system.

The following graph shows the progress made by Council in resolving open issues since go-live. These open issues represent the outstanding payroll issues and queries from staff - not necessarily reflecting an incorrect pay.

Figure 3.1 — Progress in resolving open issues



Council management is of the view that the number of issues and queries from staff has now decreased to a more manageable level and is within a generally accepted tolerance range when benchmarked against other organisations' payroll systems.

Public Accounts Committee Review

I note that the Public Accounts Committee (PAC) in Report No. 71 of May 2006 reviewed the issues surrounding the BCC payroll system. The Committee's concerns centred around —

42. The committee wanted to examine what led to the payroll problems, what action had been taken to implement the audit recommendations and what lessons could be learned from BCC's experience with implementing and managing a large IT project.

In response to the concerns raised, the Chief Executive of the Council provided the Committee with the following information and assessment —

43. The chief executive advised that the payroll situation was caused by a combination of problems -

- *system defects – both the system itself and customisation of the system;*
- *problems with rosters and the inability to make corrections for that;*
- *inadequate change management; and*
- *inadequate user acceptance testing.*

45. She further advised that team leaders were not well trained, council did not appreciate the complexity and the diversity of the various awards, EBAs and local arrangements, and underestimated the cultural and behavioural changes required to introduce an additional 4,500 system users through employee self service.

46. The chief executive did not accept the criticism that user acceptance testing was cut short due to time constraints. She advised that it was done in accordance with approved plans, but there were critical gaps in the testing strategy that subsequently caused problems in the live environment. BCC had in place protocols to identify acceptable risk levels in respect of user acceptance testing and outstanding rectification. As it turned out the assessments underestimated the impact and the number of employees affected and this resulted in a volume of errors which far exceeded expectations. The chief executive pondered the following question —

...did everyone have the process of being able to ask the rigorous questions? Did they actually perform their functions appropriately on the project steering committee? Did people have in the back of their minds that they wanted it to go live and therefore, they really wanted it to go live?

49. The chief executive believed that BCC had in place the project management components recommended by the QAO. BCC has a program office and she considered that the business requirements were fully defined. What was not totally understood was how the existing system worked and the role of the payroll staff. She advised that the contract specifications referred to the complexity of the payroll system and the numbers of rosters but she was unsure whether they were actually fully implemented.

3.1.3 Conclusion

The Chief Executive Officer has provided a good summary of the project. The answers to the questions that she has posed are critical to a complete understanding of the issues impacting on the project's performance. I note that there had been three "go-live" dates that were not achieved and I can appreciate that there were consequences for not implementing the payroll system on 27 June 2005. However it would seem that from the analysis of the nine criteria as discussed previously there was a good deal of risk in taking the "go-live" decision.

The Chief Executive Officer also clearly articulated lessons learned from the payroll implementation when addressing the Public Accounts Committee. Overall it appears that this was a case where sufficient governance structures were in place to achieve the target project outcomes however a frank assessment of readiness may have been lacking.

Chief Executive Officer response

The Chief Executive Officer advised on 13 July 2006 —

"...As you are aware, I have been actively involved in the issues surrounding the system including my appearance before the Public Accounts Review.

Accordingly I think the summary is very fair and I am comfortable with the report going forward as is..."

Lord Mayor response

The Lord Mayor in his response dated 18 July 2006 stated —

"...the draft is consistent with my understanding of the situation and I am therefore satisfied with its content."

3.2 Department of Employment and Training (DET) — review of TAFE student enrolment information

3.2.1 Introduction

TAFE Queensland comes under the auspices of the Department of Employment and Training (DET). It is the public provider of vocational education and training in Queensland, offering over 800 accredited programs through a network of 15 TAFE Institutes. The Queensland Government provides direct funding to TAFE Institutes to deliver training to meet the State's strategic and regional training priorities. These Institutes also receive funding from the Queensland Government for the provision of training for apprentices and trainees. In 2005-06, 251,900 students undertook training at TAFE Queensland for an estimated 36.4 million annual hours' curriculum.

As part of the 2005-06 financial and compliance audit of DET, the QAO conducted a review to determine whether there are suitable frameworks and systems in place to support the effective management and accurate recording of student enrolment and outcome information. As student enrolments form the basis for the majority of activities undertaken by DET funded Registered Training Organisations, incorporating TAFE Institutes, the accuracy of this information has financial and propriety implications.

3.2.2 Audit objective

The overall objective of QAO's audit was to determine whether DET has in place suitable frameworks and systems to ensure the accuracy and completeness of student enrolment and outcome information received from TAFE Institutes.

3.2.3 Audit scope and coverage

To achieve the audit objective, QAO examined three categories of information —

- accuracy and completeness of student information, including enrolment and outcomes;
- adequacy of controls used by DET in its management of various systems used to record student information; and
- appropriateness of funding standards used by DET to allocate funding to TAFE Institutes.

The primary focus of the audit was on student enrolments (showing an outcome) during the 2004 and 2005 calendar years. QAO examined the policy, procedures and practices relating to student enrolments (including recognition of prior learning/credit transfer) adopted by DET's central administration and three TAFE Institutes.

QAO also examined DET's review mechanisms for student enrolment and outcome information through an examination of reports relating to reviews conducted by DET or external organisations. This audit did not examine TAFE Institute decision-making relating to student enrolment or the competency of Institute staff making those decisions.

3.2.4 Audit findings

DET policy and procedures for TAFE Queensland

As part of this review QAO examined the relevant policies and procedures used by DET and individual TAFE Institutes in delivering the core activity of vocational education and training in Queensland. The purpose of these policies and procedures is to provide guidance to the various institutes in the management and maintenance of student enrolments and to ensure the requirements of the *Vocational Training and Employment Act 2000* and *Vocational Training and Employment Regulation 2000* are met.

QAO examined the procedures and policies at three selected TAFE institutes and found that two of the TAFE Institutes examined had suitable frameworks in place to ensure the accuracy and completeness of student enrolment information and that their procedures provided clear guidance to Institute staff. The third TAFE Institute was in the process of redeveloping its policy framework to be consistent with the framework set down by the Australian Government and DET.

QAO noted that whilst the TAFE Institutes' examined had separate written policies and procedures to support their core business processes, DET was not able to provide documentation to the audit that would indicate that the Department had in place better practice guidelines for the network of TAFE Institutes on core business processes, including governance, student education and services, human resource management, business improvement and risk management.

RECOMMENDATION 1

That DET develop better practice guidelines for its network of TAFE Institutes on core business processes to provide consistent guidance to TAFE Institutes.

Director-General response

The Director-General, Department of Employment and Training advised in a letter dated 18 July 2006 as follows —

- *Accepted — the desirability of consistent processes is constantly reviewed and debated particularly client service matters and where shared ICT systems are used. A centralised approach focuses on Government policies, Public Service directives and related legislative requirements. TAFE institutes are Registered Training Organisations (RTOs) in their own right with legal responsibility for developing procedures under Australian Quality Training Framework.*

Recognition of prior learning and credit transfer

DET has in place a comprehensive policy for the recognition of prior learning and credit transfer - *Policy for Recognising Competence through Recognition of Prior Learning, Credit Transfer and Mutual Recognition (February 2004)*. This policy provides adequate definitions of relevant concepts and outlines the key principles of recognising competencies as well as the responsibilities of TAFE Institutes for managing the recognition of prior learning and credit transfer. QAO noted that this policy did not contain separate guidelines on international students.

At a TAFE Institute level, QAO found that the local policies and procedures on recognition of prior learning and credit transfer were adopted and these were generally consistent with the policy framework set down by DET. The Institutes' procedures place appropriate emphasis on the gathering of documented evidence and the maintenance of sufficient and appropriate records for decision-making in this area, however, on balance, these lacked contextual information and at two of the three TAFE Institutes reviewed they did not provide sufficient guidance.

RECOMMENDATION 2

That DET revise the recognition of prior learning and credit transfer policy to incorporate a section on international students.

RECOMMENDATION 3

That DET ensure that the recognition of prior learning and credit transfer policy of all TAFE Institutes is consistent in all respects with the *Policy for Recognising Competence through Recognition of Prior Learning, Credit Transfer and Mutual Recognition (February 2004)*.

Director-General response

The Director-General, Department of Employment and Training advised in a letter dated 18 July 2006 as follows —

- *Accepted — recognition of prior learning (RPL) policy will be reviewed and updated to incorporate a section on international students. Regular compliance audits for Registered Training Organisations requires institutes to have documented processes and show adherence.*

Management of student enrolment information

DET practices in regard to controls and validation processes in data collection and processing of student enrolment information were reviewed by QAO to determine if the records were maintained in accordance with DET's policies and procedures and to ensure that compliance with the Australian Vocational Education and Training Management Information Statistical Standard (AVETMISS) was maintained.

QAO found that DET had in place controls and validation processes for data collection and processing of student enrolment information submitted from registered training organisations and that the functionality of the various electronic databases ensured that requirements of AVETMISS were met. DET has developed a user manual on data coding and entry which provides the user with step by step instructions for the data entry of student enrolment information into the various electronic databases. A report prepared by DET's Internal Audit Unit in February 2006, *Operational Audit of Enrolment Practices in the Institutes' Student Administration System (ISAS)*, concluded that ISAS as an enrolment system is fundamentally effective on the criteria of accuracy in that it does enrol students, tracks student progress and issues awards, and is accurate in that reports generated reflect the data held in the data repository.

Documentation provided to the audit show that review activity of data quality has been conducted by DET on a regular basis by the Department's Internal Audit Unit or external consultants.

At the Institute level, QAO examined the Institutes' compliance with procedures for the maintenance of student enrolment and outcome information for the years 2004 and 2005. QAO found inconsistencies in compliance with the management of this information. The TAFE Institutes advised quality control reviews of student records were conducted on a regular basis to ensure that the information is accurate and complete. QAO examined these reviews and found that processes and evidence supporting the conduct of the reviews varied in content and quality. Overall, QAO found that the quality of the information on student records improved in 2005 and this had resulted from the implementation of recommendations made as part of the National Centre for Vocational Education Research (NCVER) and AVETMISS audit and other internal reviews of relevant policies, procedures and practices.

RECOMMENDATION 4

That DET develop guidelines for the network of TAFE Institutes on the conduct of internal reviews of student enrolment and outcome information.

Director-General response

The Director-General, Department of Employment and Training advised in a letter dated 18 July 2006 as follows —

- *Accepted — the Department has been involved in a Data Quality Improvement Strategy for some time. As part of this strategy, guidelines are constantly reviewed to assist institutes in the conduct of internal reviews of student enrolment and outcome information. The next iteration is expected July 2006.*

Funding to TAFE

DET funds and purchases vocational education and training services from public and private providers, and owns the public TAFE network. In 2004-05, Queensland TAFE Institutes were provided funding of \$550m.

The funding for TAFE Institutes is provided under the terms and conditions set out in an annual *TAFE Institute and Agricultural College Performance Agreement*. The performance measurement framework set out in this Agreement is based on output targets. This agreement also stipulates that TAFE Institutes must comply with all applicable Commonwealth, State and Local Government laws, regulations and standards, namely the *Vocational Educational, Training and Employment Act 2000* (Qld), the *Vocational Educational, Training and Employment Regulation 2000* (Qld), the AQTF and the AVETMISS. TAFE Institutes must also meet standards of performance against three broad key performance indicators: compliance with the AQTF, client satisfaction and agreement compliance.

The *Resource Management Responsibilities for Public Providers* document was issued by DET to support TAFE Institute Directors in their management of the performance agreement. This resource is designed to support DET's performance management, which is based on the *Financial Management Standard 1997*; that is, to monitor agency financial and operation performance and to evaluate the achievement of agency goals and the delivery of its outputs.

DET owns the public TAFE network and it is ultimately responsible for the financial performance of TAFE Institutes. QAO examined the documentation at DET used to support the funding of the vocational education and training delivered through the TAFE network. QAO found that the TAFE funding framework used by DET was based on output targets. A recent effectiveness and efficiency review conducted by an external consultant provided DET with comments on their funding structure and recommendations for improvement. This external review commented that the funding of the TAFE Institutes was allocated on an historical basis rather than reflecting real training costs or values.

Annually, TAFE Institutes prepare business plans which are linked to the DET Strategic Plan. The funding arrangements for the Institutes are based on the Institutes' business plans. The Queensland Training and Employment Priorities (QTEP) planning process is used to guide its funding decisions, thereby aligning vocational education and training priorities to funding arrangements. DET conducts an annual review with the individual TAFE Institute Directors to discuss the Institute's performance during the year and the terms and conditions of the next financial year's performance agreement. It is through this process, DET addresses the issue of underachievement of targets. The recent effectiveness and efficiency review stated that TAFE Institutes regularly fail to meet annual performance targets and the gap has increased substantially over the last four years. The report further stated that this underperformance had little or no effect on direct grant agreements in subsequent years.

RECOMMENDATION 5

That DET revise its performance framework for TAFE Institutes to address the gap between agreed annual performance targets and actual performance.

Director-General response

In response to the recommendations, the Director-General, Department of Employment and Training advised in a letter dated 18 July 2006 as follows —

- *Accepted – DET's performance management framework has been evolving. From 05/06 a far more rigorous, and intrusive performance management framework commenced with the newly created position of Executive Director, Operations having direct accountability under a notional 'ownership and operational management' role for the public provider network. Performance indicators using standardised efficiency and effectiveness measures are benchmarked and regular high level and in depth analysis of all public provider performance is conducted monthly. Hard deliverables are written within each Institute Director's Performance Agreement and Institute Directors are regularly called to account across a range of well defined targets and ratios. While EOY is not completed, improved notional output efficiency 05/06 compared with 04/05 is expected to be \$20m.*

RECOMMENDATION 6

That DET develop a funding framework that adequately addresses underperformance.

Director-General response

The Director-General, Department of Employment and Training advised in a letter dated 18 July 2006 as follows —

- *Accepted — as outlined above. We have implemented redirection of government grant funding from TAFE institutes that can not deliver contracted training to institutes who can. These measures lead to \$10m being reallocated during 05/06 financial year.*

3.2.5 Conclusion

QAO's review of the student enrolment systems within DET found that on balance, reasonable frameworks and systems exist to ensure the accuracy and completeness of student enrolment and outcome information by TAFE Institutes. However there are opportunities for improvement.

QAO considers that gaps found in policies, procedures and practices adopted by individual TAFE Institutes have impacted upon the accuracy and completeness of student records within TAFE Institutes for years 2004 and 2005. The audit found that over the past 12 months DET has been endeavouring to enhance the systems, procedures and practices that support student enrolment information. In this regard, QAO noted that in 2005 the accuracy and completeness of student enrolment information was better in comparison with that in 2004, due to improved record keeping practices which had corresponded with a focus on internal reviews of policies, procedures and practices by individual TAFE Institutes.

QAO considers that the opportunity exists for DET to develop TAFE-wide policies and procedures on core business processes which could provide better practice guidelines and greater consistency in the maintenance of student enrolment information. The Director-General, Department of Employment and Training has accepted the audit recommendations and has provided an assurance that action will be taken and/or is in the process of being implemented to address the audit findings.

3.3 Department of Health — review of Caboolture Emergency Department tender process

3.3.1 Background

From late December 2005 Queensland Health experienced increasing difficulty in maintaining a full service Emergency Department at the Caboolture Hospital. At that time, Queensland Health also experienced staffing difficulties at other hospitals. The Caboolture Emergency Department was ultimately downgraded to a primary service level facility on 16 January 2006 which meant that it would be on bypass for Queensland Ambulance Service initiated presentations and that patient retrieval services could not be provided within the District.

Based on the suggestion of a clinician who was providing services to Caboolture Emergency Department on a temporary basis, Aspen Medical Pty Ltd and Queensland Health engaged in preliminary discussions regarding delivery of health services to Emergency and Intensive Care Unit Departments. Subsequently, on 2 February 2006 this company submitted a number of written proposals to Queensland Health for the supply of health services including the Caboolture Emergency Department. Further discussions occurred with senior departmental officers regarding the possibility of this company providing a solution for some of the staff shortages. On 3 February 2006 the General Manager Central Area Health Service and the Director-General determined that a formal tender process would be required for the Caboolture Emergency Department and the unit responsible for tendering processes, Health Services Purchasing and Logistics Branch, was assigned this responsibility.

Initially, Queensland Health developed a tender for a standing offer arrangement to provide a panel of suppliers for the provision of medical services in Emergency Departments. Documentation for a separate tender specification was also commenced for the engagement of a consultant to undertake a complete review of the Caboolture hospital. On 14 February 2006 these two tenders were combined to focus on a consultancy for the review of medical services at Caboolture Emergency Department and implementation of the solutions offered.

The final objectives of the consultancy tender, as quoted in Part B, Specification and Terms paragraph 2.2, were identified as —

- *“Development and implementation of an appropriate model of care for an outer-metropolitan emergency department;*
- *Development and implementation of robust HR strategies, including planning of short and long term workforce requirements and recruitment of staff to fulfill those requirements;*
- *Identification and implementation of systems that support ongoing development and retention of staff, including but not limited to education, research, and professional and career development;*
- *Identification of policies and procedures to support hospital operations and ensure ongoing accreditation with the Australian Council of Healthcare Standards and the Australasian College of Emergency Medicine;*
- *Increased efficiencies through streamlining systems and processes; and*
- *Provision of best practice emergency care for an outer Metropolitan Emergency Service.”*

The tender specification also included the following paragraph —

“Queensland Health is prepared to accept considerable flexibility in staffing models (staff employed by Queensland Health, staff employed by the Consultant [with transition to Queensland Health employment at project termination] or a blended model).”

Queensland Health officers have advised that the tender specification was subsequently issued via mail and email to Aspen Medical Pty Ltd and Anodyne Services Australia on 15 February 2006.

The tender closed on 24 February 2006 with only one tender being received, from Aspen Medical Pty Ltd. Departmental records indicate that an unsuccessful attempt was made to contact Anodyne Services Australia by telephone. The tender evaluation panel assessed the adequacy of the one tender received and recommended that the tender submission be accepted subject to clarification of a number of issues by the tenderer. On 27 February 2006 an officer from the Health Services Purchasing and Logistics Branch issued a request for further information to the tenderer. A meeting was held between Queensland Health officers and the tenderer on 28 February 2006. On 1 March 2006 the tenderer provided responses direct to the District Manager Redcliffe/Caboolture Health Service District. The same day a briefing note was prepared from the District Manager Redcliffe/Caboolture Health Service District and forwarded to the Director-General recommending acceptance of the tender at a cost of \$18,515,624 for two years.

Instead of preparing a single contract based on the standard terms and conditions contained in the tender specification, two distinct contracts were proposed, one for the provision of the consultancy services as per the specifications of 14 February 2006 and one to implement the solutions offered to manage the Caboolture Emergency Department. Each contract contained the same terms and conditions. After further negotiations between Queensland Health and Aspen Medical, the two contracts were subsequently signed on 7 March 2006 and the provision of the services commenced on the signing of the contracts. Based on the signed contracts, the cost for the provision of the consultancy service was identified as \$1,708,438 and \$14,152,043 for the implementation of the service solutions at the Caboolture Emergency Department service.

Following a request on behalf of the Director-General dated 21 April 2006 for the conduct of a review of the tender process for the Emergency Department Services at Caboolture Hospital, I decided in the public interest to extend the scope of my normal interim audit to specifically include a review of this tender process.

3.3.2 Scope of audit

The Director-General requested that QAO undertake an urgent review of the procedural correctness of the recent tender for Emergency Services at Caboolture Hospital. As our routine audit involves a review of compliance with the State Purchasing Policy and Departmental policies and in light of the materiality of this transaction, I requested my staff to include this transaction within our audit scope in addition to our normal review of a sample of purchasing transactions.

In relation to the awarding of the contracts the audit objectives were —

- (a) Review of the department's local purchasing policies to determine whether they comply with the requirements of the State Purchasing Policy; and
- (b) Review of the tendering processes used for the transaction involving the Caboolture Emergency Department to ensure compliance with the requirements of the State Purchasing Policy and local policies and procedures (Financial Management Practice Manual and Agency Purchasing Procedures).

The audit was limited to a review of the following documentation —

- State Purchasing Policy (Second edition, published 2004);
- Queensland Health's Agency Purchasing Procedures dated 1 July 2001; and
- Documentation provided by Queensland Health at QAO request in relation to the tender for Engagement of a Consultant for the Review of the Caboolture Hospital Emergency Department (Reference No PL129/1).

As I determined my focus to be on the documented processes, no discussions occurred with either the Tender Review Panel or the Tenderers. Discussions took place with the Director-General and other Corporate Office employees associated with the tendering process.

3.3.3 Audit findings

(A) Purchasing policies

The State Purchasing Policy and associated documentation consists of —

- the Policy itself including its intent, objectives, operation and administration;
- Foundation Concepts that explain the Policy objectives and Operational Concepts that outline how to apply operational aspects of the Policy;
- Agency Purchasing Procedures that are provided by each agency to outline their purchasing systems and practices; and
- a series of stand-alone Better Purchasing Guides that assist agencies and suppliers to understand Government purchasing practice.

Compliance with the State Purchasing Policy is required by a Cabinet decision and is applicable to all public sector agency purchasing activities. In 2000, the State Purchasing Policy was amended significantly from the previous policy and a phased implementation occurred with Queensland Health required to comply from 1 July 2001. The State Purchasing Policy has three equally ranking objectives or Foundation Concepts that are required to be satisfied for all purchasing decisions —

- to advance Government priorities;
- to achieve value for money; and
- to ensure probity and accountability for outcomes.

As indicated above the State Purchasing Policy requires agencies to develop local Agency Purchasing Procedures that satisfy the requirements of the State Purchasing Policy and outline the agency's purchasing systems and practice. Queensland Health have developed Agency Purchasing Procedures which are dated 1 July 2001. The Agency Purchasing Procedures incorporates the State Purchasing Policy objectives including the specific requirements to address the following —

- annual corporate procurement plan;
- plans for significant purchases;
- organising and managing the purchasing function;
- probity and accountability measures;
- information gathering and analysis;
- buying strategies and practices; and
- complaint handling procedures.

However, the State Purchasing Policy has been updated since its initial release in 2000 and is now marked as a Second Edition, published 2004. This version of the State Purchasing Policy contains a more recent listing of Government priorities which are not currently reflected in Queensland Health's Agency Purchasing Procedures. Of particular note is the fact that the current Government priorities contain specific priorities related to the provision of health care. As one of the Foundation Concepts of the State Purchasing Policy is to advance Government priorities, (without the current Government priorities being documented in the Agency Purchasing Procedures), there is a risk that Queensland Health's purchasing activities may not adequately focus on advancing those priorities.

Queensland Health has already instigated an extensive review of its Agency Purchasing Procedures. This process has been underway for over 12 months and is scheduled for completion in December 2006.

RECOMMENDATION 1

Queensland Health should consider and implement agreed recommendations arising from the current review of Agency Purchasing Procedures, as soon as possible, ensuring all changes are consistent with the current State Purchasing Policy.

(B) Tendering processes

Given the community expectations that existed at the time this tender was being developed and evaluated, it is acknowledged that significant pressure was placed on departmental officers to maintain a full service Emergency Department at Caboolture. Given the speed with which the options were considered, tender specifications developed, the tender evaluated and a contract finalised and signed it is not unreasonable to conclude that this would have contributed to failures in the process of fully documenting the decisions made during the tender process.

QAO would expect an open tender process would as a minimum include the following —

- determine product requirements;
- determine the most appropriate purchasing strategy;
- consider the need for a probity auditor;
- develop Tender Specification;
- undertake a Market Analysis;
- advertise publicly;
- issue Tender Specification to those who request one;
- evaluate tender submissions;
- prepare Tender Evaluation Report;
- negotiate with selected tenderer;
- develop and sign contract;
- manage arrangement with supplier; and
- monitor Supplier performance.

While a streamlining of the process could occur where tender offers are confined and there is a degree of urgency in completing the process (as in the current instance), I believe conducting Market Analysis to identify potential suppliers, the processes for the issue of tender specifications, and negotiating with the selected tenderer become critical factors.

In my view, Queensland Health considered these matters, but the full extent of that consideration could not be determined because all aspects were not fully documented. These instances are discussed below under the headings of Market Analysis, Tender Specifications, Tender Negotiations, Contract Development, and Purchasing Strategy.

Market analysis

The initial market analysis completed by Queensland Health appears to have been assigned to an officer of appropriate technical expertise shortly before the Tender Specification was issued. This analysis involved a review of suppliers available from the Internet and discrete enquiries with Commonwealth employees who were considered to be knowledgeable of suppliers in this field. However, the market analysis undertaken was not formally documented and filed on the official tendering file. QAO noted that formal documentation of the market analysis was not a specific requirement of the Agency Purchasing Procedures.

One of Queensland Health's key guiding principles in the Agency Purchasing Procedures is to "Base purchasing decisions on market competition." The Agency Purchasing Procedures discuss the concept of "Narrow markets" in s.11.4 with the following paragraph being particularly relevant —

"With corporate internationalisation, take-overs, mergers, joint ventures etc, coupled with rapid product innovations, it can often be difficult knowing how many appropriate suppliers there are in particular markets. It is in these circumstances that the use of a competitive market strategy excels."

This section supports the concept of competition particularly in the situation of rapid product innovations as was the case with the services being requested in this instance.

Without formal documentation of the Market Analysis that was undertaken by Queensland Health officers there is no evidence to demonstrate the process was transparent and accountable.

RECOMMENDATION 2

The market analysis should be formally documented and include reasons for the exclusion of any potential suppliers. This requirement should be documented in the Agency Purchasing Procedures.

Tender specifications

Queensland Health's current policy states that the hard copy tender specification is the only official version with the electronic version merely provided by e-mail to prospective tenderers as an assistance to the tenderers in completing their tender submissions. The tender documentation states that it is the tenderer's responsibility to ensure that the electronic version is the same as the hard copy version issued should the electronic version be utilised in the preparation of the response to the tender.

The process employed to issue the tender documents did not conform with the requirements of the Agency Purchasing Procedures in that the issue of the Tender Specification to the two identified potential suppliers was not recorded on a "Record of Offers Requested or Received" register as required by section 14.3 of the Agency Purchasing Procedures. In addition, Queensland Health's standard procedure to issue the Tender Specification without covering letters can lead to confusion by a recipient of an unsolicited Tender Specification and make the issue of transparency more difficult to assess.

As a result, Queensland Health was unable to produce any documentary evidence to QAO that the hard copy Tender Specifications were in fact issued. The only documentation provided to audit were printouts of the emails purportedly issued to each entity providing the electronic versions of the Tender Specification. No electronic receipt or other documentation to verify delivery/receipt could be provided to QAO. Also Queensland Health advised they had no evidence of the non-delivery of either the electronic or the hard copy of the tender specification.

RECOMMENDATION 3

The issue of tender specifications should be recorded in accordance with the requirements of section 14.3 of the Queensland Health Agency Purchasing Procedures. In addition consideration should be given to issuing tender specifications under cover of a formal letter.

RECOMMENDATION 4

Queensland Health should consider expanding the requirements of the Queensland Health Agency Purchasing Procedures to establish the action to be taken when a limited response is received to a tender invitation.

Tender negotiations

Based on the signed contracts, Queensland Health was able to negotiate a reduced purchase price for the provision of the consultancy and Caboolture Emergency Department service than was offered in the original tender submission received from the successful tenderer.

The two contracts signed on 7 March 2006 were for a total of \$15,860,480 for the services to be provided for the two year life of the contracts. While the contract prices demonstrate that negotiations resulted in a lower cost to Queensland Health, the documentation of the negotiation process was not comprehensive. The negotiation process was conducted by officers outside of the Health Services Purchasing and Logistics Branch. Normal purchasing protocol would require an officer from Health Services Purchasing and Logistics Branch to manage the negotiation process.

QAO noted that the Agency Purchasing Procedures does not contain specific provisions on the documentation requirements for post tender negotiations nor is this a specific requirement of the State Purchasing Policy although detail is provided in the Better Purchasing Guide of the State Purchasing Policy. While it could reasonably be expected that an experienced contract negotiator would be aware of the need to document a negotiation process, in this instance the negotiations were undertaken by an officer external to the Health Services Purchasing and Logistics Branch. The necessity for proper documentation in a tender negotiation process should be clearly enunciated.

RECOMMENDATION 5

Queensland Health should expand the requirements of their Agency Purchasing Procedures to include procedures to be followed in conducting and documenting post tender negotiations and ensure that officers undertaking such negotiations are familiar with these requirements.

Contract development

Good business practice would require any departure from the use of approved contract templates for the provision of goods and services and those proposed for specialised needs to be reviewed by legal professionals to ensure the interests of the agency and Government are protected. The QAO review found that the Queensland Health Legal and Administrative Law Unit were not requested to review the contracts prior to signing by the Department. QAO noted that while the original Tender Specification requested a submission for the review of the Caboolture Emergency Department plus the implementation of the outcomes from that consultancy review, separate contracts were ultimately prepared and signed for each of these components.

The two separate contract documents were identical in form and content except for the Payment Schedule attached to each contract. The format utilised for the consultancy contract closely represented the format of a standard consultancy contract used by the Department. However, these standard consultancy terms and conditions were not tailored to suit the supply of services focus of the second contract.

This situation has potentially exposed Queensland Health to greater risk should a contract dispute arise, due to the possible absence of standard clauses designed to protect Queensland Health's interests. It is understood that efforts have subsequently been undertaken to amend the contracts to ensure Queensland Health's interests are protected by way of a supplementary agreement.

RECOMMENDATION 6

Queensland Health should ensure that all major or specialised purchase contracts that vary from the standard approved templates used by the Department or where the standard template does not apply, be reviewed by the Legal and Administrative Law Unit prior to signing by the Department.

Purchasing strategy

From QAO's review of the documentation provided, it is unclear which purchasing strategy Queensland Health intended following for the Caboolture Emergency Department transaction. Given the genuine urgency that existed, Queensland Health could have legitimately employed the urgent provisions of the Agency Purchasing Procedures which allows Queensland Health to confine offers for the tender (Agency Purchasing Procedures s.9.3) and simply issued a specification to one identified supplier without the need to consider any other providers (Agency Purchasing Procedures s.9.8). However, this option requires the reasons for limiting open and effective competition to be documented and approved by an appropriately delegated officer, with the overriding requirement that the decision must be both transparent and defensible. Documentation to support the application of this option was not provided to audit.

The second option, allows Queensland Health, in situations where known limited markets exist, to issue Requests for Offers to all known suppliers. In issuing the tender specification to two potential suppliers, Queensland Health appear to have adopted the procedures relevant to this approach.

The application of this particular section may have been difficult in practice, as the market appears to be a new and emerging one. Consequently, Queensland Health's knowledge of all potential suppliers within this market may have been limited.

Queensland Health ultimately received only one tender submission. To determine value for money in this particular purchase, Queensland Health conducted an analysis to compare the costs of the submission against Queensland Health's own costs to resource the Caboolture Emergency Department. As indicated elsewhere in this report post tender evaluation negotiations resulted in a combined contract price of \$15,860,480. The contract price contained a premium against the comparable costs for Queensland Health to resource the Emergency Department. QAO has not reviewed the appropriateness of the resourcing model used as the basis to determine Queensland Health costs to resource the Caboolture Emergency Department and therefore provides no comment on this aspect of the tender.

RECOMMENDATION 7

Queensland Health should ensure processes are documented and approved as required for the specific purchasing strategies adopted.

3.3.4 Overall conclusion

The Department of Health identified that the re-establishment of the Caboolture Emergency Department was a serious issue that required urgent attention given the community concerns regarding the adequate provision of health care. This pressure led to the Department endeavouring to reduce the timeframes associated with the Caboolture Emergency Department tendering process to the absolute minimum. These minimum timeframes dictated a sharing of responsibilities for the various processes associated with the purchase across operational and administrative lines, where ordinarily these processes would be managed by Health Services Purchasing and Logistics Branch. Audit testing of a limited number of other tendering processes within the Department have not identified similar issues to those identified in this particular tender.

The audit has not identified any evidence of officers not conducting themselves in good faith in completing the tender process. This report identifies as a key finding an inadequate level of documentation maintained as part of the tender process. The requirement to get the Caboolture Emergency Department back to a 24 hour 7 day operation in the circumstances described may have been an influencing factor in the tendering process utilised.

Acting Director-General's response

The Acting Director-General advised on 14 July 2006 —

...Overall I note that you have not identified any evidence of officers not conducting themselves in good faith, and that your recommendations generally focus on the need for improved levels of documentation surrounding tender processes.

Adequate documentation in purchasing processes is important and I will ensure that improvements are made in this important area of Queensland Health's administration. I also stress that the current review of purchasing guidelines by Queensland Purchasing supports this direction and indicates a general desire to improve documentation of purchasing processes across Government agencies.

In the context of your findings it is important to stress that Queensland Health faced major workforce shortages earlier this year which resulted in reduced emergency department services to the Caboolture community. Our main imperative was to restore full services to the community as soon as possible. As you rightly point out, the identification of potential suppliers and the assessment of tenders were consequently carried out in an expeditious way. As a result, we now find that some detailed documentation of processes was lacking.

However, I am relieved you have found that required purchasing policies and processes were not compromised. I also stress that the outcome of the tender has resulted in the successful reestablishment of the emergency department at Caboolture Hospital, including the attraction and recruitment of a number of additional clinical staff, previously unavailable to Queensland Health. The service is now seeing as many clients as it was this time last year.

With regard to your specific recommendations, I make the following comments:

Recommendation 1: Agreed — Queensland Health is committed to implementing the recommendations of our Agency Purchasing Procedures review. This review will also include recommendations of adequate minimum documentation required for closed tender processes.

Recommendation 2: Agreed — Whilst I accept that documentation was not detailed enough, some basic documentation of the evaluation process was made and this was included on our purchasing file. It does provide evidence of the market analysis process adopted. As you note, an appropriate technical expert carried out the evaluation.

Recommendation 3: Agreed — I would note, however, that issuing of formal letters needs to be supplemented by evidence of an appropriate receipt of tender specifications by potential suppliers. In future, Queensland Health will be implementing a process where tender specifications sent to potential suppliers will be by registered mail, and emailed copies will be sent with appropriate electronic receipt return. I would also note that both potential suppliers targeted in the Caboolture Emergency Department Tender process were recorded and documented on our purchasing records. Queensland Health's view is this complies with the requirements of maintaining formal register in terms of section 14.3 of the Agency Purchasing Procedures.

Recommendation 4: Agreed — This will be included in our Agency Purchasing Procedures.

Recommendation 5: Agreed — Our Agency Purchasing Procedures will be expanded to include procedures to be followed in conducting and documenting post tender negotiations. In this case negotiations resulted in a significant reduction in the final price accepted by Queensland Health in comparison to the original price tendered by the successful supplier.

Recommendation 6: Agreed — Revised procedures based on a risk management approach have been implemented since April 2006.

Recommendation 7: Agreed — I would note however, whilst documentation was insufficient, some base recording of the purchasing strategy adopted was documented. This indicates our strategy was a result of a combination of both genuine urgency and limited market. As you are aware government procedures entitle us under circumstances of a genuine urgency or a limited market, to enter into a closed tender process, which may involve the selection of only one potential supplier. In our specific instance we elected to endeavour to find multiple potential suppliers to ensure the transparency of the process.

I would note that Queensland Health used an appropriate model as the basis to determine Queensland Health costs to resource the Caboolture Emergency Department. The cost model used was based on the Caboolture Emergency Department budget build, which is comprehensively reviewed annually and monitored monthly to ensure appropriateness of cost inputs for services delivered.

Thank you for the opportunity to provide comment on your audit report. I acknowledge the recommendations made and accept your findings that Queensland Health staff acted in good faith during the tender process. Their efforts have resulted in the restoration of a viable 24 hour Emergency Department to the Caboolture Community...

3.4 Department of Tourism, Fair Trading and Wine Industry Development — update on property agents and motor dealers trust accounts

In Report No. 2 for 2005, tabled in Parliament on 16 June 2005 a commentary was provided on the work undertaken by the Department of Tourism, Fair Trading and Wine Industry Development to strengthen controls over the calculation and remittance of interest due on trust accounts established under the *Property Agents and Motor Dealers Act 2000*.

As a result of the Department undertaking a number of actions, an additional \$4.1m relating to the 1998-99 to 2004-05 financial years has been collected.

The actions included —

- calculating the correct interest due on the trust accounts;
- determining the amount of late payment penalties owing;
- identifying payments received from the financial institutions that should have been remitted to other entities;
- determining overpayments made by the financial institutions; and
- quantifying any amounts to be settled between the Department and individual financial institutions based on the information received.

The Department is maintaining control over the Property Agents and Motor Dealers trust account transactions as discussed in Report No. 2.

Director-General's response

The Director-General advised on 19 June 2006 that —

The Department of Tourism, Fair Trading and Wine Industry Development recognises the importance of rigorous financial arrangements for Property Agents and Motor Dealers trust accounts. The Department has devoted significant resources to enhance the internal control environment applying to these accounts. Further, the Department has fostered effective relationships with relevant financial institutions to ensure compliance with specified requirements.

3.5 Queensland Rail — update on controls over a portion of containerised freight revenue

In Report No. 4 for 2004-05 it was reported that the 2004-05 financial statements of Queensland Rail (QR) were qualified on the basis of non-compliance with the prescribed requirements in that a key control over a portion of containerised freight revenue was not operating for the majority of the financial year.

QAO recommended that QR –

- ensure timely reconciliations between Freight Accounting System (FAS) and Rollingstock Information Control System (RICS) are performed throughout the year;
- ensure all policies and procedures within the Containerised Freight area are adequately documented and all staff trained in the importance of following the required procedures;
- enhance governance processes across all business areas of QR to increase the awareness of the need for adherence to the internal control framework and procedures; and
- establish and maintain a program of periodic self assessment of systems that will identify weakness, provide assurance that internal controls are operating as intended and remain relevant, reliable and cost-effective.

QR advised that whilst this matter did not have a material effect on QR's financial statements, it acknowledged that a breakdown in internal controls over a portion of containerised freight revenue did occur and accepted QAO's recommendations and instigated action to address this matter.

Since the matter was initially reported, QR management have taken significant steps to ensure the timely completion of reconciliations between FAS and RICS are performed throughout the year.

QR's Internal Audit Unit conducted a review over the adequacy and effectiveness of existing controls over the billing of containerised freight and management actions to rectify deficiencies identified by QAO.

QAO has confirmed that the revenue reconciliations between the FAS and RICS systems are being performed in the current financial year.

Chairman's response

In a response dated 28 June 2006 the Chairman of QR advised —

The issues relating to the breakdown in controls over a portion of the containerised freight revenue, which resulted in the issuing of a qualified audit opinion, was a serious matter that the QR Board closely monitored via the Audit and Risk Management Committee. It is pleasing that the corrective actions taken by QR management have rectified the control breakdown.

3.6 Interim audit issues

3.6.1 Background

The audits of public sector entities fall into three main phases: the planning phase, where risk is assessed and the audit strategy developed; the interim audit phase, where the auditors test the internal controls implemented by management; and the final audit phase where detailed transaction testing and verification of financial statement figures is undertaken.

Where there is a good system of internal controls operating throughout the year, the risk of fraud and error is substantially reduced and management and audit gain assurance that the amounts reported in the agencies' systems and financial statements are materially correct. The detailed testing of transactions carried in the final phase of the audit is then able to be reduced.

Internal controls are defined by the *Financial Management Standard 1997* (the FMS) as the methods adopted within an entity to safeguard its assets, check the accuracy and reliability of its accounting information, and secure compliance with the prescribed requirements that apply to the entity. The development and maintenance of sound internal control frameworks is the responsibility of management.

A strong system of internal control consists of three components —

- The control environment — the attitudes and actions of the Accountable Officer or Board and senior management about monitoring and reporting of actual results. In a strong control environment, it will be important for management to communicate requirements to staff and have in place systems to monitor and report on compliance.
- Information systems — the systems designed to record transactions and events completely and accurately and then report in ways which provide the Accountable Officer or Board and management with timely information necessary to evaluate how well the intended results are being achieved.
- The control procedures — procedures which respond to recognised risks over the achievement of timely and accurate information. Procedures should require checking of the completeness and accuracy of the recording and reporting of transactions and events, and the safeguarding of assets.

General comment is provided below under these three components on some of the breakdowns in internal controls identified as part of the interim audits of the larger public sector agencies. The matters reported did not apply to all agencies, but were common enough to suggest the need for attention from a broader public sector perspective.

3.6.2 Control environment

Section 69 of the FMS requires agencies to develop and implement a control environment which includes a strong emphasis on accountability, best practice management of the agency's resources and internal control and an organisational structure and delegations which is supportive of the agency's goals and operations.

Audit identified a number of issues indicating that appropriate monitoring and reporting was not always in place or that agencies had not complied with legislative requirements, including —

- strategic planning documents not being updated;
- business continuity plans not being finalised; and
- instances of non-compliance with Financial Management Practice Manuals.

To maintain an effective control environment, it is essential for public sector agencies to comply with relevant legislation, and to maintain a Financial Management Practice Manual which accurately reflects the agency's current policies and procedures.

3.6.3 Information systems

Controls need to be maintained by agencies over the access and use of their financial and human resources systems to ensure that the data within these systems is accurate and valid. The FMS (s.70) requires that information systems must be developed to ensure all transactions are recorded accurately, completely, promptly, during the correct accounting period, and in a way that allows for the preparation of financial reports under the prescribed accounting standards. Among the requirements of s.70(2) are that each information system must control access to the system and maintain an adequate audit trail.

A number of issues relating to information systems controls, in particular user access control measures, were raised with agencies during the course of the interim audits and a detailed analysis of these issues will be included in a future Report to Parliament.

3.6.4 Control procedures

Section 71 of the FMS requires that internal controls must be developed and implemented to ensure the effective, efficient and economical management of the agency's resources, and to accomplish the agency's strategic goals. These control procedures should include internally checking and independently verifying data, preparing reconciliations and other administrative controls; properly authorising transactions and activities; and preparing reasonable documentation and records on a timely basis.

Among the issues relating to inadequate control procedures reported to agencies were —

- reconciliations for revenue and receivables, expenditure and accounts payable, assets, and between subsidiary ledgers and the general ledger were not always being completed;
- instances were found where changes to vendors were not being approved or being made without appropriate supporting documentation;
- there was not always regular review of vendors being carried out to ensure that vendor details were still valid and there were no duplicate vendors;
- outstanding purchase orders not being regularly reviewed to ensure that financial commitments could be accurately determined;
- payroll systems reports such as starters and leavers were not being actioned to ensure that all modifications being made to payroll system data were valid;
- credit cards were not always used correctly, credit card policies were not being followed in all cases and transactions were not being reconciled to statements; and
- asset acquisitions were not always being identified and recorded on a timely basis.

3.6.5 Future action

Agencies where these issues have been raised during the interim audit phase have been encouraged to take any necessary action to address the issues identified before the audits for 2005-06 are finalised. Action taken will be followed up with the applicable public sector agencies in the final phase of the audit and where appropriate will be included in a later Report to Parliament.

3.7 Controls over electronic funds transfer (EFT)

3.7.1 Introduction

Contemporary payment processing systems are increasingly reliant on EFT systems to facilitate payments between public sector entities and vendors such as suppliers of goods and services or recipients of grant funding. As with all systems, the benefits of their use also have associated risks which need to be effectively managed.

Public sector entities facilitate their EFT transactions through desktop banking systems¹. In these systems, the ability to authorise the movement of funds from public sector bank accounts and speed of clearance of funds between bank accounts requires strong controls to be in place to manage risk, error or misappropriation. These controls should include —

- ensuring information such as payment instructions can not be altered when transferred from the entity's financial systems to the desktop banking system;
- appropriately limiting access to the desktop banking system;
- controlling the ability or removing the ability to alter information transferred to the desktop banking system prior to its transmission to the financial services provider's banking system;
- confirming the accuracy of data transferred between systems;
- preparing bank reconciliations on a timely basis to enable identification of any withdrawals from bank accounts requiring investigation;
- controlling the creation and maintenance of vendor and employee bank account details; and
- documenting and periodically monitoring compliance with established policies and procedures.

Controls over EFT using desktop banking systems at a sample of 10 public sector entities were audited in 2004 and the results of the audit reported in Report No. 4 for 2004-05. This audit indicated that controls over EFT systems were not always in place or operating effectively. Based on these results, it was decided to expand the audit to cover a broader range of public sector entities, including departments, statutory bodies, government owned corporations and local governments. In total, 146 public sector entities were reviewed as part of this broader review.

The results of the review of controls over EFT systems in 44 local governments were reported in Report No. 1 for 2006 tabled in Parliament on 5 May 2006.

3.7.2 Overall results

While the results from the expanded review indicated a general improvement in controls over EFT transactions processed through desktop banking systems, there was evidence to suggest that some entities have not yet fully appreciated the risks of desktop banking systems and their dependency on the controls within traditional financial systems.

The review conducted in 2004 recommended that regular reviews of controls over EFT using desktop banking systems should be conducted by public sector organisations. It is pleasing to note that since this recommendation was made, entities including Corporate Solutions Queensland and Queensland Treasury Corporation have taken the initiative and proactively commissioned reviews of controls over their EFT systems. These entities are to be commended on action taken to improve the controls and security over their EFT systems.

¹ An explanation of desktop banking systems and how they work is included in Report No. 4 for 2004-05 available at www.qao.qld.gov.au.

3.7.3 Audit findings

The key issues identified as a result of the audit —

- improved protection was required to minimise the risk of manipulation of transaction data during its transfer between an entity's financial and desktop banking systems;
- the functions assigned to user accounts within desktop banking systems did not support the segregation of duties;
- passwords to access EFT systems were not being changed on a regular basis;
- bank reconciliations were not being completed or reviewed in a timely manner to ensure anomalies were identified;
- insufficient controls were in place to ensure the validity of changes to bank account details held for vendors and employees; and
- instances of where passwords and user accounts were shared.

3.7.4 Experiences and learnings

During the course of the recent review, I was advised by two public sector entities in accordance with section 42 of the *Financial Management Standard 1997* where losses had been detected which had been facilitated through the use of the EFT process. In both cases the loss incurred was less than \$20,000. These case studies are provided to allow other entities to learn from the experiences and highlight the need to maintain strong internal controls over the EFT process.

Case Study 1

A duplicate payment occurred due to procedural controls not being followed. In this case, a manual procedure was not performed that overwrote the previous day's banking file. Also the person authorising the payment did not review the relevant documentation to confirm that the amount being paid via EFT agreed to the number and amount of transactions recorded in the finance system prior to authorising the payment as per the entity's documented procedures.

The duplicate payment identified on two occasions over the ensuing six week period but no action was taken to correct the error and its occurrence was not communicated to senior management.

A loss was incurred by the public sector entity as by the time corrective action had been taken, the vendor receiving the duplicate payment had gone into receivership.

What should have been done differently?

Timely review of the bank statement identified the error but no effective action was taken. Action must be instigated to correct errors in a timely manner. Management should also ensure that they are informed of the results of the reconciliation process.

It is important that established policy and control procedures be followed. If the documented payment authorisation procedures had been followed, the error would have been identified and corrected prior to the funds transfer occurring.

Senior management responsible for payments need to be informed should such an error occur and be kept informed of action being taken to correct an error. An organisational culture should be fostered which encourages open communication between management and staff and the diligent review of work being performed.

Case Study 2

A public sector entity advised that one of its employees had on 14 occasions in a six month period transferred monies from the entity's bank account to their own bank account.

This was not detected until a complaint was received by the public sector agency from a vendor questioning a refund that they did not receive which was listed on their client statement.

What could have prevented this?

In this case, the main control being relied on to detect this fraudulent activity was the vendor reviewing and questioning the details on their statement but this control is not sufficiently reliable to safeguard EFT transactions in a timely manner.

In order to make EFT payments, bank account details must be obtained from an entity's vendors and employees and these details are generally retained within the entity's accounts payable system. If these bank account details are not correctly maintained and controlled, there is a potential for funds to be accidentally or fraudulently misdirected. Ensuring that only valid account details are entered and only authorised changes are made to bank account details limits this potential. This can be ensured through review of supporting documentation by a supervisor prior to the change occurring to certify a valid change is being initiated.

3.7.5 Conclusion

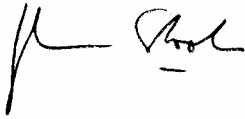
Regular review of controls over EFT using desktop banking systems by all public sector entities is essential to ensure these controls continue to be adequate and operating effectively. QAO will monitor and review EFT systems as part of our normal audit process and make recommendations to individual entities for improvements to their EFT controls.

Section 4

Acknowledgements

The assistance and co-operation of the Ministers, Members of Parliament and public sector entities is noted and appreciated.

I acknowledge the efforts and commitment of all QAO staff and contract auditors in the performance of the audits and their willingness to assist the public sector entities. I extend my thanks to QAO staff who contributed to the preparation of this Report.



Glenn Poole
Auditor-General

Section 5

QAO publications

5.1 QAO publications

Publication	Date Released
Annual Report 2005	November 2005
INFORM	
Issue No. 17	June 2006
Issue No. 16	October 2005
Issue No. 15	April 2005
Issue No. 14	August 2004
Guidelines	
Better Practice Guide — Output Performance Measurement and Reporting	February 2006
Management of Infrastructure Assets by Local Governments	December 2005
Better Practice Guide — Strategies for Earlier Financial Statement Preparation	December 2005
Fact Sheet AASB 1 — First Time Adoption of Australian equivalents to IFRS	August 2004
QAO Guidelines on Accounting Standard AASB 136 — Impairment of Assets	July 2004
Practical Examples of IFRS	April 2004
Checklist for Organisational Change — Managing MOG Changes	February 2004
Applying IFRS to the Public Sector — Frequently Asked Questions	December 2003
Checklist for CEOs, Boards and Accountable Officers, prior to signing Financial Statements	November 2003
Other	
Performance Management Systems Audits — An Overview	January 2006
QAO Auditing Standards	September 2003

5.2 Auditor-General's Reports to Parliament 2006

Report No.	Subject	Date of Report	Date tabled in the Legislative Assembly
4	Auditor-General's Report No. 4 for 2006 Results of Audits completed at 31 May 2006 including Universities and Grammar Schools	19 July 2006	1 August 2006
3	Auditor-General's Report No. 3 for 2006 Results of 2004-05 Aboriginal Shire Council and Torres Strait Island Council Audits	17 July 2006	25 July 2006
2	Auditor-General's Report No. 2 for 2006 Results of Performance Management Systems Audits of Government Owned Corporations' Performance Reporting	23 May 2006	5 June 2006
1	Auditor-General's Report No. 1 for 2006 Results of Local Government Audits for 2004-05	26 April 2006	5 May 2006

