Queensland Audit Office

Results of audit: Internal control systems

Report to Parliament 6 : 2013–14

Queensland Audit Office

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Queensland Audit Office

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The Honourable F Simpson MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Madam Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled Results of audit: Internal control systems.

In accordance with s.67 of the Act, would you please arrange for the report to be tabled in the Legislative Assembly.

Yours sincerely

Andrew Greaves
Auditor-General

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Summary

Internal financial controls are the structures, organisational capabilities, systems, processes, procedures and activities within an entity that together operate to reduce the risk of fraud and error in financial reports. They do not and cannot eliminate such risks altogether: the cost of attempting to do so would outweigh any benefits in terms of matters such as improving the reliability of the annual financial statements.

The Director-General of each department is responsible for establishing and effectively maintaining adequate financial control throughout the financial year. The external auditor needs to consider the internal controls capability of each entity when planning our financial audits. We do this by first evaluating their design and implementation. Depending on the outcome of our initial evaluation we may then decide also to test the operation of selected financial controls, but only if we consider it is efficient and effective to rely on them.

This report summarises the results of our initial control evaluations and of our selective testing of the financial reporting controls that operated within the 20 government departments during the 2012–13 financial year. These departments represent the bulk of the General Government Sector revenues and expenses.

While the controls tested in each department will vary between agencies and years, this year we also considered the control over the use of corporate cards in all departments. The major thrust of the report however is the results of our detailed assessment of the three primary mechanisms used by the Director-General of each department to monitor the health of their own internal control frameworks:

- chief finance officer (CFO) certifications
- internal audit activities
- audit committee oversight.

Conclusions

During 2012–13 we continued to identify and report on a range of significant control weaknesses across a number of departments relating to their control environment, information systems and control activities. While the total number of control weaknesses identified has declined, internal control structures are not yet as strong as they need to be for risk of fraud and material error to be reduced to acceptable levels.

The continuation of relatively high numbers of significant control activity findings points also to weaknesses in the mechanisms for monitoring of controls by departments. Greater attention to strengthening the monitoring of key controls, within a top-down risk approach, will pay dividends by better balancing risk and control; focusing on strengthening those controls that are important and reducing or eliminating unnecessary control.

Findings from selective control testing

Across all departments, excluding issues identified at Queensland Shared Services, we reported 103 high or moderate risk control weaknesses to management during 2012–13, relating to their control environments, control activities and information systems.

Figure A
High or moderate control weaknesses reported to management

Control element	2011–12		2012–13	
	Departments	Issues	Departments	Issues
Control environment	9	23	8	15
Control activities	8	47	15	66
Information systems	11	67	7	22
		137		**103**

Source: QAO

Control environment

The control environment sets the context within which control activities are undertaken. It establishes the control culture and includes matters such as the assignment of authority; the capacity and capability of staff; and the comprehensive and currency of the strategies, plans, policies and procedures that guide operations.

While most aspects of the control environment in departments were sound, we observed in eight departments that selected policies and strategies could be improved.

A high risk issue was raised with the Department of Community Safety about the department's corporate card policies and procedures, which are tailored to their routine operations rather than management of procurement of essential services in times of major emergency events like cyclones and floods. This is a high risk issue as management of these events is a prime function of the department. Systems need to be designed to enable the procurement of services and goods under these conditions and still retain individual accountability for transactions incurred. The department is aware of this matter and taking steps to address it.

The other 14 control environment issues identified during our financial audits were rated as moderate risk. These related primarily to lack of corporate procurement strategies and an IT security strategy.

Control activities

Control activities are the checks and balances over financial transactions and other events that operate to prevent fraud or error, or to detect it and correct it, should it occur. They include controls such as separating duties that are in potential conflict–like issuing invoices, recording and banking receipts, and providing for doubtful debts. They also include activities like reconciling general ledger accounts to bank statements; and having purchasing officers verify and certify that the goods and services they ordered have been received, before another independent officer approves and pays the supplier.

We identified control activity weaknesses in 15 departments this year (eight last year) relating to various aspects of their accounting and supporting systems and processes.

The major control activity deficiencies we identified were:

- inadequate segregation of key duties across expenditure and payables; employee expenses and benefits; and revenue and receivables. This increases the risk of users having access to two or more functions within a process that may lead to inappropriate activities such as fraudulent payments or misappropriation.
- lack of evidence of review of reconciliation and verification reports.

While no high risk issues were identified, which is positive, the increase in the number of moderate risk rated weaknesses reported to management this year compared to last, is cause for some concern. It should be taken as an "early warning" signal that greater attention needs to be paid by management to making sure the controls they have designed and implemented are operating as they intended. As alluded to in last year's internal control report, the turnover and loss of corporate staff, combined with changes in organisation structures, increase the risk that controls will break down. This year's results indicate that this has been the case.

Information systems

Information systems (IS) are integral to a department's internal controls, as they are used to produce financial management information and external reports. Information system controls operate at two levels:

- general controls that relate to the entire information system, such as logical security controls and controls over software development
- application-specific controls over data validation, authorisation, monitoring and reporting, such as in-built edit checks and the automated restriction of access to certain functions only to those with delegated authority.

Together these controls operate to restrict access to systems, data and programs to authorised users, and to properly align their access rights with their authority and responsibility. Without adequate controls, it is difficult to safeguard information against unauthorised use, disclosure or modification, damage or loss, and the integrity of the data cannot be guaranteed.

It is positive that there has been a decline in the number of IS weaknesses reported his year; and within this a decline in the relative proportion of security weaknesses identified in the information systems controlled and operated by departments. Information security control weaknesses account for 14 of the 22 IS control issues identified (64 per cent), compared to 56 of the 67 issues raised last year (83 per cent).

Of the 22 issues reported, only one high risk issue was identified, at the Department of Community Safety. The department did not have a formal system security plan for its ESCAD system that includes monitoring and reporting of any security breaches. This critical system is used for computer aided dispatches and incident management by Queensland Fire and Rescue Services and Queensland Ambulance Services. The system's availability and integrity are at risk of security breaches. The department has advised that it is currently taking steps to address this issue.

Shared Services

Queensland Shared Services (QSS) facilitates a range of corporate services to 18 of the 20 departments, excluding the Department of Health (DoH) and the Department of Education, Training and Employment (DETE). These services include finance, procurement, human resource management, facilities management and mail support services.

Under these shared service provider arrangements, the 18 departments require assurance that their transactions have been processed completely and accurately by the provider. This is because the Director-General remains responsible for the internal controls which relate to the department's transaction processing, even where there is a third party providing processing services. To this end, the department needs to take appropriate measures to gain assurance that there are no material weaknesses in the end to end processing of its transactions.

External audit plays a role in this assurance process by conducting an annual assurance audit pursuant to the Australian Auditing Standard ASAE 3402 *Assurance Reports on Controls at a Service Organisation*. This standard requires QAO as the auditor to provide an assurance report about the descriptions of controls for relevant QSS systems, including whether the controls operated effectively throughout the specified period.

The resulting QAO report details control weaknesses detected and is provided to all of the service provider's clients. For 2012–13, we raised 34 moderate risk issues (2011–12: 37 moderate risk issues) relating to required improvements in systems descriptions, defining the agency and service provider responsibility for internal controls, and security and monitoring controls for the information systems. These 34 issues were in addition to the 103 control issues discussed above raised directly with departments.

Issues we raised in 2011–12 have largely been addressed which indicates that QSS are committed to continuous improvement of their internal controls.

Controls over corporate cards

Controls over corporate cards fall into two areas of the internal control framework. There should be control activities to address identified corporate card risks, and monitoring of corporate card controls to assess whether these controls are effective.

We found sound internal controls for issuing corporate cards across all 20 departments; however improvements are required in some departments over card acquittal, return and cancellation, and over the monitoring of irregular transactions.

All departments could benefit from monitoring of overall card expenditure patterns and from defining benchmarks and targets to maximise the benefits of corporate card use.

Departments were not reviewing the merits of their respective strategic procurement requirements to enable more effective card use. Ten per cent of cards were not used within the last 12 months and 15 per cent were low use, averaging $235 a year.

If all transactions under $5 000 are paid for using corporate cards, administrative cost savings in excess of $10 million each year could be made.

Findings about monitoring controls

We found that the three key internal control monitoring mechanisms required strengthening variously across a number of departments.

CFO certifications

The *Financial Accountability Act 2009* (FAA) requires each of the 20 departmental CFOs to give a certificate each year to their Director-General, including a statement about whether the department's financial internal controls are operating efficiently, effectively and economically. The Financial and Performance Management Standard 2009 (FPMS) sets out the form of this certificate.

The purpose of the CFO certification is to provide confidence to the Director-General that financial internal controls put in place by the CFO are operating and therefore that the likelihood of a material misstatement in the financial statements is low.

We found that most departments had robust CFO certification processes. However improvements could be made in the design of the processes by better documenting how the process will work, consulting earlier with the Director-General, and clearly aligning and describing the significant financial reporting risks with relevant account balances and with the key internal controls being assessed.

Internal audit

All departments had in place the frameworks required for effective internal audit functions, with comprehensive charters governing their establishment and operations. All these departments also had access to suitably experienced, qualified and organisationally independent resources.

Even with these foundations in place, we found eleven departments' internal audit functions require further improvement. This was because these departments either had no documented and approved internal audit work plan established, or the level of internal audit resources applied was well below relevant comparative benchmarks.

In four departments (20 per cent), high risk issues identified and reported by internal audit are not being addressed by management on a timely basis, calling into question the effectiveness of internal audit as a catalyst for strengthening controls.

Queensland Treasury and Trade (QTT) does not align itself with one accepted better practice, as the role of its head of internal audit (HIA) has been allocated to its CFO. These roles are inherently in conflict, and this creates risk for the Under Treasurer and for the QTT audit committee in terms of the ability of the HIA to maintain an independent outlook and achieve an appropriate balance in its internal audit program.

Audit committee oversight

The role of departmental audit committees is to operate independently of management and assist the Directors-General to discharge their responsibilities for the efficient, effective and economical use of public resources. This is done by the committees providing independent oversight and reporting to the Director-General about governance and internal control frameworks, financial reporting and compliance with relevant legislation. We found that all 20 departmental audit committees had comprehensive charters to govern their ongoing operations, regular meetings to monitor the internal control environment and adequately documented proceedings.

However we found there were six departments where their audit committees' operations required improvement. Two of these six had memberships larger than average and recommended numbers, but with low external member representation; and also had long outstanding high risk internal audit issues awaiting resolution. The combination of these factors indicates that substantial scope for improvement remains if they are to be fully effective.

When management dominates the membership of the audit committee, there is a higher risk of conflict of interest situations. We found 14 departmental audit committees had independent membership of less than 50 per cent. The Under Treasurer has requested of a long term strategy to appoint more independent members, so that ideally at least half of the members are independent.

Recommendations

The control matters raised in this report have been represented separately to each department as required by auditing standards, with the intent that where weaknesses and areas for improvement have been identified, they take their own remedial action.

Accordingly, no additional overall recommendations have been included in this report.

Reference to comments

In accordance with section 64 of the *Auditor-General Act 2009*, a copy of this report was provided to all departments with a request for comments.

The agencies' views have been considered and are represented to the extent relevant and warranted in preparing this report.

A fair summary of the comments received are included in Appendix A of this report.

1 Context

1.1 Internal controls

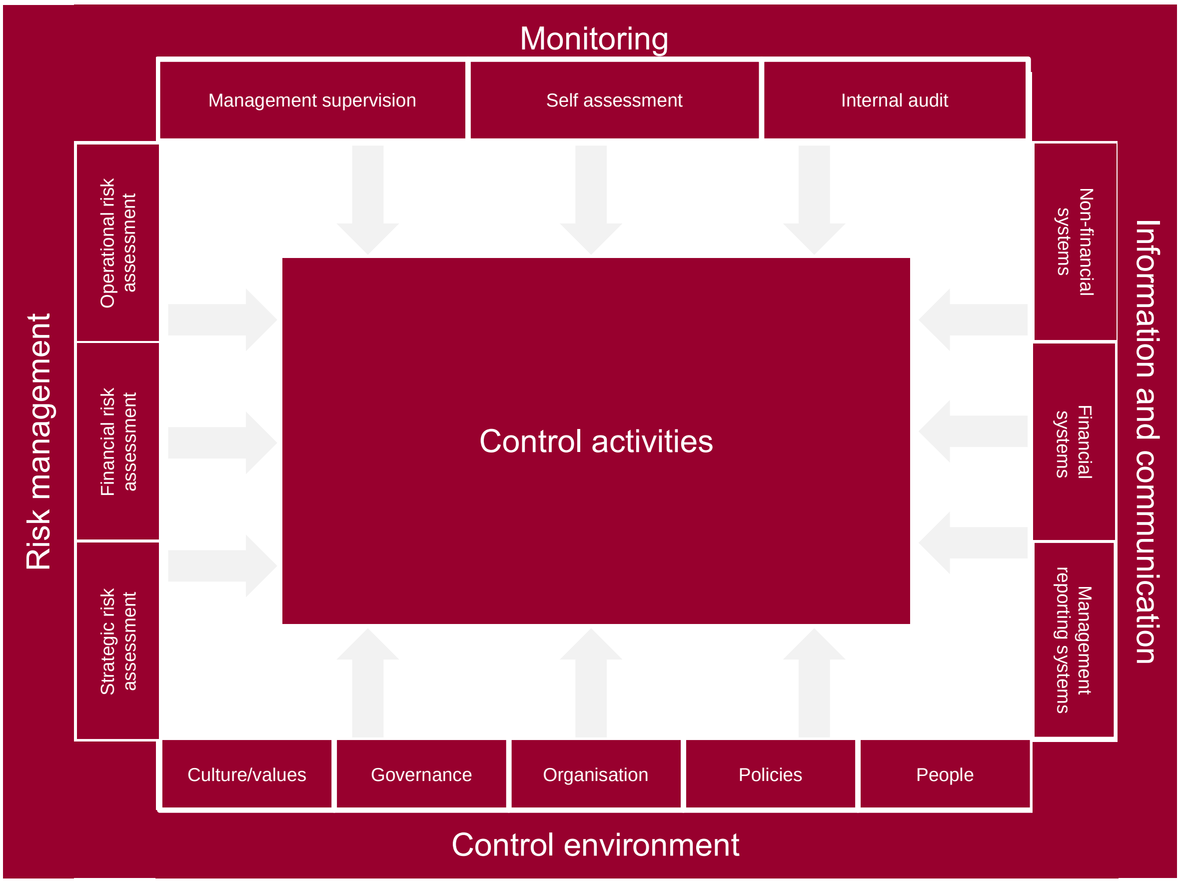
Internal controls are processes (including policies, procedures and systems) that are established, operated and monitored by the management of an entity to provide reasonable assurance to them and to their governing body about the achievement of their objectives.

An integrated system of internal control reduces the risks an entity must overcome to achieve its objectives. Internal controls cannot eliminate risk. They operate to assure management about:

- the effectiveness and efficiency of an entity's operations
- the reliability of internal and external financial reporting
- the compliance by the entity with laws and regulations.

Figure 1A illustrates the components of an internal control framework.

Figure 1A
Components of an internal control framework



Source: Queensland Audit Office adapted from Internal Control: Integrated Framework—Committee of Sponsoring Organizations of the Treadway Commission, American Institute of Certified Public Accountants, 2011

In Figure 1A the five core elements of an integrated system for control are:

- **control environment**—management's actions, attitudes, policies and values that influence day to day operations. Control environment factors include management's integrity and operating style; organisational culture and values, organisation structure and the assignment and delegation of authority; and processes for obtaining and developing qualified and skilled employees.
- **risk assessment**—management's processes to consider risks to the achievement of the organisation's objectives, forming a basis for how the risks should be managed.
- **control activities**—the policies and procedures implemented that help ensure management directives are carried out and that necessary actions are taken to address identified risks. Control activities operate at all levels and in all functions. They include activities such as approvals, authorisations, verifications, reconciliations, reviews of operating performance, securing assets and segregation of incompatible duties.
- **information and communication**—the systems used to provide information in a form and time frame that allows employees to discharge their responsibilities; and the way that control responsibilities are communicated throughout the entity.
- **monitoring of controls**—the methods management employs to oversee and assess the operating effectiveness of control activities in practice. This may be achieved through ongoing supervision, periodic self assessments and separate evaluations.

1.2 Management responsibility

Section 61 of the *Financial Accountability Act 2009* (FAA) states that accountable officers and the boards of statutory bodies are to ensure the operations of the department or statutory body are carried out efficiently, effectively and economically; and are to establish and maintain appropriate systems of internal controls. These two responsibilities are internally consistent and mutually supportive.

Section 8 of the Financial and Performance Management Standard 2009 (FPMS) requires departments and statutory bodies to establish cost effective internal control structures.

These legislative requirements make the Director-General of a department responsible for all internal controls. Within this, the chief finance officer (CFO) is made primarily responsible for maintaining appropriate internal financial controls for the department.

An adequate system of financial control will help to ensure that financial records and related information are complete and accurate; assets are safeguarded; and errors and other irregularities are prevented or detected and corrected. As the system of financial control underpins the information presented in the annual financial statements, it operates to help make sure that these statements give a true and fair view of the departments' transactions and financial position for each financial year.

To reinforce responsibility in this respect, each year, under section 77 of the FAA, the CFO is required to provide a statement to the Director-General, who is the accountable officer, as to whether the financial internal controls of the department operated efficiently, effectively and economically.

1.3 Audit responsibility

The FAA and its subordinate legislation, the FPMS, provide the legislative requirement for departments to prepare general purpose annual financial statements and present them to the Auditor-General for audit.

The primary objective of our financial audits, as identified in the Auditor-General of Queensland Auditing Standards which incorporate the Australian Auditing Standards, is to provide independent assurance to Parliament and the community that the information contained in the financial statements is, in all material respects:

- free of misstatement, whether due to fraud or error
- presented fairly in accordance with applicable accounting standards and legislative requirements.

Because internal financial controls operate to produce reliable financial information and to maintain compliance with prescribed requirements, we are required to consider their effectiveness as part of our annual audit of each entity's financial statements.

This involves first considering the design of relevant controls under each of the five core elements of the integrated control structure. At this stage of the audit, we review and evaluate each department's key internal controls to assess their capacity to prevent and detect errors that may result in a material misstatement of the financial statements.

Our assessment of the effectiveness of the department's internal controls influences the timing and extent of our audit procedures. If we consider the controls to be well designed and implemented, we may choose to rely on the operation of selected controls. If we plan to rely on controls, we are required by the auditing standards to confirm that they operated in practice as intended.

If, in our professional judgement, we determine that controls are not well designed; that any of the controls that we tested did not operate as intended; or that controls should be in place but are missing, we are required by the auditing standards to communicate such control deficiencies to management. We assign a risk rating to any internal control deficiencies we raise so management can gauge their relative importance.

Significant control deficiencies must be communicated in writing to those charged with the governance of the entity and we assign these either a high or moderate risk rating:

- A **high** risk rating is applied where we have identified a serious control weakness or breakdown in the operation of a key control or combination of key controls, indicating the risk of material error or fraud in the financial statements is unacceptably high. These require prompt management action with a detailed action plan implemented quickly, generally within one to three months.
- A **moderate** risk rating is applied where we have identified a control weakness or breakdown in the operation of a control that it is not likely to prevent or detect the errors for which it was designed. These require management action with a detailed plan to be implemented within three to six months.

We assign a low risk rating to any other control deficiencies we identify and these are more likely to be communicated directly to line management:

- A **low** risk rating is applied where we have identified weaknesses or breakdowns of a procedural or housekeeping nature and where the controls in question either relate to immaterial areas or if they are compensating, rather than key, controls. These require management action with a detailed plan to be implemented within six to twelve months.

Section 60 of the *Auditor-General Act 2009* requires the Auditor-General to draw attention to any case in which the functions relating to the financial management of the public sector entity were not performed adequately and properly, if the Auditor-General considers the matter to be significant enough to require inclusion in the report. By reporting on the significant control deficiencies we observed in departmental internal control systems, this report satisfies these requirements.

1.4 Structure of the report

The findings detailed in this report focus principally on the monitoring of financial reporting controls by management, one of the five elements of an integrated internal control framework.

Central to effective monitoring of financial controls is the annual control self assessment and certification provided by the Chief Finance Officer (Chapter 2); the work of internal audit (Chapter 3); and the oversight activities of the audit committee (Chapter 4).

This year, we also specifically examined how effectively internal controls are applied to the use of credit cards by departments (Chapter 5).

1.5 Department acronyms

Department of Aboriginal and Torres Strait Islander and Multicultural Affairs (DATSIMA)

Department of Agriculture, Forestry and Fisheries (DAFF)

Department of Communities, Child Safety and Disability Services (DCCSDS)

Department of Community Safety (DCS)

Department of Education, Training and Employment (DETE)

Department of Energy and Water Supply (DEWS)

Department of Environment and Heritage Protection (DEHP)

Department of Health (DoH)

Department of Housing and Public Works (DHPW)

Department of Justice and Attorney General (DJAG)

Department of Local Government, Community Recovery and Resilience (DLGCRR)

Department of National Parks, Recreation, Sport and Racing (DNPRSR)

Department of Natural Resources and Mines (DNRM)

Department of the Premier and Cabinet (DPC)

Department of Science, Information Technology, Innovation and the Arts (DSITIA)

Department of State Development, Infrastructure and Planning (DSDIP)

Department of Tourism, Major Events, Small Business and the Commonwealth Games (DTESB)

Department of Transport and Main Roads (DTMR)

Queensland Police Service (QPS)

Queensland Treasury and Trade (QTT).

2 Chief finance officer certification

In brief

Background

The chief finance officer (CFO) is required by the *Financial Accountability Act 2009* (FAA) to give a certificate each year to his or her Director-General that includes a statement about whether the department's financial internal controls are operating efficiently, effectively and economically. The form of this certificate is set out in the Financial and Performance Management Standard 2009 (FPMS). Our objective was to look beyond the certificate to establish whether it was underpinned by robust processes to provide adequate assurance to the Director-General.

Conclusion

The CFO statements of assurance for most departments are underpinned by a robust framework, applied in a way that provides a high level of assurance about the operation of key financial controls during a financial year.

Where lower levels of assurance are not made explicit in reporting, there is an increased risk of the Directors-General of departments having a false sense of comfort about the operational effectiveness of their internal financial controls.

Key findings

- The CFO controls assurance framework could be strengthened by better documentation of the framework.
- The implementation of a specific register that focuses on financial reporting risks would improve the process for all departments.

2.1 Context

Under the *Financial Accountability Act 2009* (FAA), the chief finance officer (CFO) of each of the 20 departments is delegated responsibility by his or her Director-General for financial resource management which includes responsibility for establishing, maintaining and reviewing financial internal controls.

The annual certificate provided by the CFO to the Director-General must include the following statements:

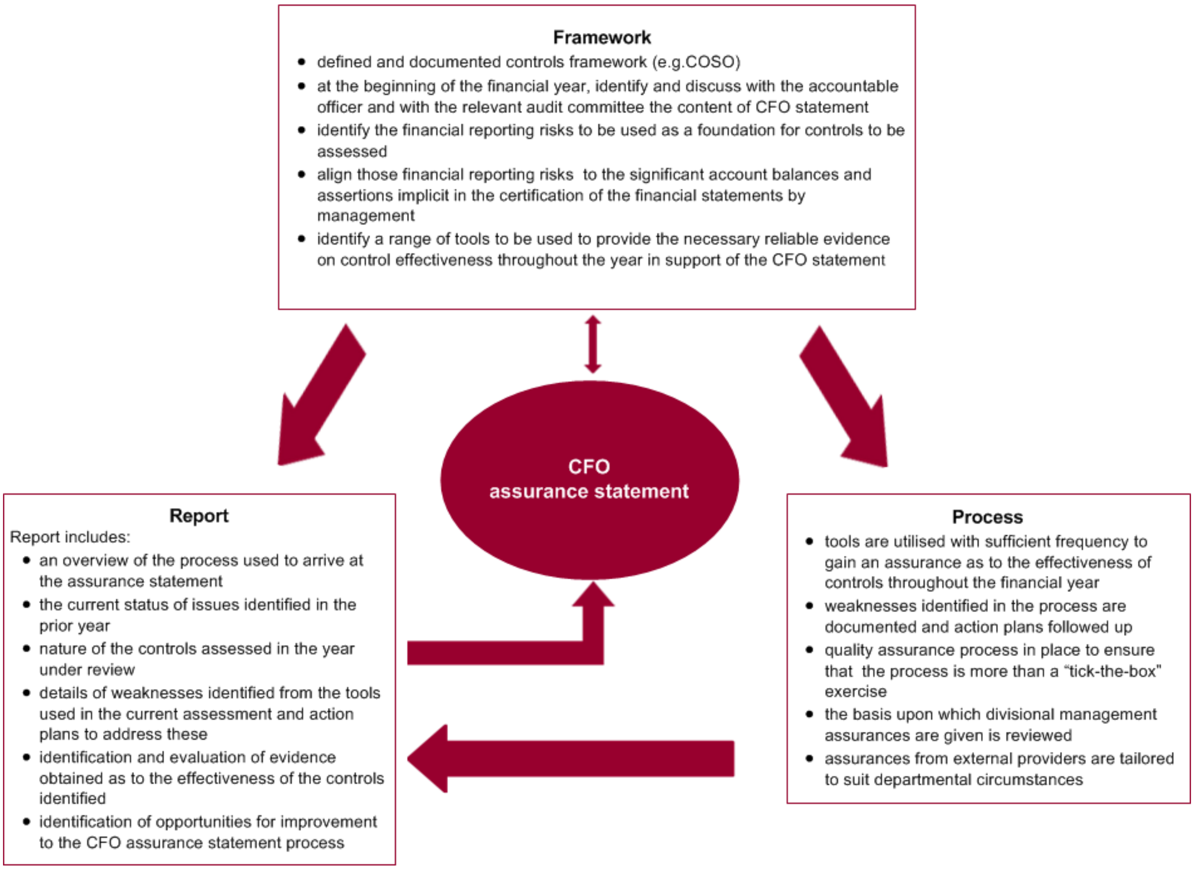
- whether the financial records of the department have been maintained properly throughout the financial year in accordance with the prescribed requirements
- whether the risk management and internal compliance and control systems of the department relating to financial management have been operating efficiently and effectively throughout the financial year
- since the balance date:
  - whether there have been any changes that may have a material effect on the operation of the risk management and internal compliance and control systems of the department
  - if there have been any changes—details of the changes
- whether external service providers have given assurance about their controls.

Financial internal controls are a subset of all internal controls but they are not separately defined in the FAA, or in the supporting Financial and Performance Management Standard 2009 (FPMS). Their scope, however, can be derived from context and, in this respect, financial internal controls are clearly intended to be those that operate to produce reliable financial statements free from material misstatement, whether caused by fraud or error. At a minimum, they are controls that:

- pertain to the maintenance of records that, in reasonable detail, reflect accurately and fairly the transactions of an entity and the disposition of its assets and liabilities
- provide reasonable assurance that transactions and other events are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures are being made only in accordance with authorisations of management
- provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of assets that could have a material effect on the financial statements.

Figure 2A provides an overview of the better practice CFO certification framework.

Figure 2A
Better practice CFO certification framework



Source: QAO

2.2 Audit objectives

As part of our annual financial audit, we routinely consider each department's approach to its own review and assessment of its internal controls, including the CFO certification.

Our objective this year was to look beyond the certificate to establish the assumptions behind the CFO assurance statement and to gauge the level of assurance being provided to the Director-General about the efficient and effective operation of key financial internal controls.

In forming our conclusions, our assessment considered:

- **design**—the risk and control assurance framework adopted
- **application**—the implementation of the framework over the period
- **reporting**—the form and content of the annual certification and supporting documentation.

To form a positive conclusion, we expected to find that:

- design—there was a clear understanding at the beginning of the year between the Director-General and the CFO about the significant risks; the controls being examined; the approach to test these controls; and the desired level of assurance expected to be obtained from these tests
- application—there was sufficient and appropriate evidence obtained and documented to demonstrate that the controls were tested in operation throughout the year
- reporting—the certificate provided was in the form required by the FAA and FPMS and the accompanying report contained reference to, or was supported by, the evidence obtained.

2.3 Conclusions

For most departments, the CFO statement of assurance is underpinned by a robust framework, applied in a way that provides a high level of assurance about the operation of key financial controls during a financial year.

In some cases the level of assurance obtained is not as high. Where these lower levels of assurance are not made explicit in reporting, there is an increased risk that the Directors-General of departments have a false sense of comfort about the operational effectiveness of their internal financial controls.

Areas that require most attention across departments include the need to be more explicit about the major financial risks; the key controls most relevant to these risks; whether and to what extent they are being evaluated; and the planned level of assurance.

Earlier dialogue with a Director-General about these matters—ideally at the beginning of each year—would serve to strengthen the process, as would confirming that key financial controls operated during the entire period rather than just at a point in time.

2.4 Findings summary

All departments' compliance with reporting requirements were assessed as satisfactory. We found three areas in design of the CFO assurance framework that could be strengthened across departments:

- the control assurance framework adopted and being assessed is not clearly documented
- documentation is lacking of the consultation between the CFO and the Director-General or with the Audit Committee at the beginning of the year, and during the year, to clarify their assurance requirements and expectations
- documentation is lacking of consideration of the risks of material error or fraud inherent in the financial statements to establish which financial controls are the most important and what level of comfort is required about the operating effectiveness of these key controls.

2.5 Design

The Financial Accountability Handbook (the handbook), issued by Queensland Treasury and Trade requires the CFO certification to be based on a documented assurance framework.

The approach taken in the FAA to the annual assessment of financial internal control by the CFO is not new in financial reporting control frameworks. It reflects better practice in the certification process of financial statements and mirrors closely the rationale and current requirements for publicly listed companies in the United States, flowing from the reforms under the *Sarbanes-Oxley Act 2002* (SOX). A less prescriptive form of sign off is required under s.295A of the *Corporations Act 2001* (Cth) for chief financial officers of listed public companies.

What is less clear from the FAA and FPMS is the level of assurance required of the CFO about the design and operation of his or her financial internal controls. Given the significant context of the annual certification and its close relationship to the financial statements, it is reasonably inferred that a high level of assurance is required. The CFO must be confident no material internal control weaknesses exist and, consequently, the likelihood of a material misstatement in the financial statements is remote.

The handbook, which supports the FAA and FPMS, provides some guidance to CFOs in the level of evidence required to support their certification process. Volume 4 IS 4.2 Statement by Chief Finance Officer of the handbook states:

> *…Given the wide range of transaction and financial controls in place in most agencies, it would be difficult to attest to each one. It is therefore considered reasonable that a risk-based approach be adopted…*

The risk-based approach adopted is a matter of professional judgement by the CFO; however, the FPMS requires that departments undertake regular reviews of their internal controls and systems, including financial and risk management systems. Volume 4 IS 4.1 Monitoring and assessment of internal controls of the handbook supports this by stating:

> *…key internal controls must be documented, with a risk assessment undertaken as to the importance of the controls to the agency. This may determine the extent and frequency of reviews undertaken…*

These requirements translate to a better practice approach to establishing a suitable controls assurance framework of:

- identify the significant financial reporting risks and align these to account balances and supporting information systems, records and processes
- identify the key controls that mitigate these significant risks
- describe the procedures planned to verify the effectiveness of the key controls, including a clear statement of the desired level of assurance to be obtained for the year in relation to the key controls
- discuss and agree the risks, controls and procedures with the Director-General and seek endorsement by the audit committee before any work is undertaken to test control effectiveness—ideally at the start of each financial year.

We found key areas for improvement in some departments related to the initial identification and assessment of financial risks and the subsequent alignment of these risks to financial statement balances.

All departments identified the controls over which they wished to obtain assurance but, without a robust financial risk assessment process, the right controls may not have been tested. In these circumstances, the evidence upon which the CFO certification is based may not give the high level of assurance required.

2.5.1 Identifying and aligning to financial risks

The top down risk approach in the handbook guidance mirrors the requirement of SOX section 404 *'Management assessment of internal controls'* in the United States. The top down risk approach evaluation begins with identifying and assessing the risks to reliable financial reporting, including changes in those risks since the last assessment. Management then evaluates whether it has controls in operation that are designed to address those risks adequately throughout the financial year.

Top down risk assessment requires:

- determining the significant components (that is, the significant account balances and disclosures) in the annual financial statements
- determining which management assertions (for example, accuracy, completeness, occurrence, ownership, control, classification) are relevant to these significant components
- assessing the inherent risks of material misstatement by each assertion.

To do this requires that the CFO has a clear understanding of the flow of transactions within the department and of the associated systems, so that the point at which a material error or fraud is most likely to occur is able to be identified.

A risk register establishes a sound basis for documenting the CFO's understanding and analysis of significant financial risks, including financial reporting risks.

Whilst all departments have risk management systems, including risk registers, their registers did not always articulate financial reporting risks at the level of detail required for CFO certification. Without this level of detail, it is more difficult for a CFO to target the nature and extent of controls assurance work that needs to be undertaken to provide a robust certification.

2.5.2 Defining and documenting key controls

After obtaining a clear understanding of where the risks of material fraud and error are highest, the second step is to identify the key controls that operate to either prevent fraud and error or to detect and remedy it. This entails:

- Assess first any key entity-wide controls able to prevent or detect a material misstatement relating to a significant account balance. When such controls exist and are effective, management may determine there is no need to identify controls at lower levels.
- Identify and assess controls operating at an intermediate level within the organisation. As with entity-level controls, effective intermediate-level controls may be sufficient.
- If there are no reliably independent higher level controls, identify and assess key control activities at the system or process level.

Entity-level controls with a direct relationship to mitigating the risk of financial misstatement are:

- controls to prevent management override such as segregation of duties
- controls over systems for centralised processing of financial information, including using technology; for example, information technology security over databases and master files, policies on change control, monitoring of exception reporting
- controls to monitor results of operations such as monthly comparisons of budget and actual results to forecasts for revenues and expenses; comparisons of other metrics, such as profit margins and certain expenses as a percentage of sales; use of financial ratios; and quarterly balance sheet reviews
- controls to monitor other controls such as compliance and investigation activities controls over the period-end financial reporting process(reconciliations; approval of adjusting journals)
- reviews conducted by the department's ethical standards branch, particularly where those reviews are related to fraud arising from a systemic breakdown in internal controls.

Where the internal controls framework is not defined and there is no clear linkage between risk and key controls, it is difficult for the CFO to demonstrate that his or her certification is based on sufficient and appropriate evidence that all key internal controls operated satisfactorily during the year.

It is also important for the CFO certification to be discussed and agreed with the Director-General as the accountable officer under the FAA. This should include consultation on the underpinning framework on which the certification is based and any changes to this framework from the previous year and, in particular, the methods to be used to gain the assurance. Consultation at the start of the financial year provides clarity for the CFO that the Director-General understands and accepts the basis on which the CFO plans to obtain the desired level of assurance.

2.6 Application

2.6.1 Procedures used and their levels of assurance

Departments use a variety of methods to achieve a high level of positive assurance about the effectiveness of the internal financial controls they wish to examine. The methods used will vary, depending on the size and complexity of each department's financial operations and the associated risk of error and fraud.

The various methods used by the departments include line management representations, internal control questionnaires/control self assessments, representations from external service providers, ethical standards unit reviews, consultant reviews and internal audits.

Figure 2B describes these methods, each of which provides different levels of assurance; for example, independent assessments of internal controls by internal audit provide a higher level of assurance than control self assessments or internal control questionnaires. Management representations provide the weakest assurance in this process.

Figure 2B
Methods to obtain controls assurance

Method	Explanation	Reliability
Management representations	Representations made by line management as to the adequacy of and effectivenss of controls	Less reliable due to lack of independence Depends on divisional management's diligence and care and attention to collecting evidence to support their representations
Internal control questionnaires/ control assessments	Systematic approach to documenting key controls and assessing each for design and operating effectiveness against identified risks	Less reliable when undertaken as a self assessment by those performing the controls Normally only performed at a point in time
External consultant	External consultants may be contracted in to review particular controls such as in relation to information technology	More reliable but not truly independent Normally only performed at a point in time
Representations from external service providers	Representations or assurances from external service providers that internal controls at those providers are operating as intended	More reliable if tailored to suit the individual department and supported by audit certfication
Ethical standards reviews	These could include specific reviews undertaken by the department's internal ethical standards unit which could relate to fraud or other misconduct	Increased independence from line management makes these reviews more reliable May only be performed at a point in time' in relation to a specific issue, less likely to be comprehensive
Internal audit	Comprehensive program of audit work covering financial and compliance reviews and review of information technology systems based on risk	Most reliable because of enhanced independence from line management and when a rigorous audit methodology is applied Can provide 'positive' assurance

Source: QAO

2.6.2 Control assessment, quality and review

The handbook sets out that the control assessment, quality and review of information gathered during the process should consider:

- the frequency of control assessment, based on risk and the need to gain assurance over the entire financial year
- the action taken or proposed to remedy a control breakdown or weakness
- a quality assurance process that is not a "tick the box" exercise
- the basis for divisional management providing assurances
- the existence of tailored assurances from the external service providers.

Frequency of control assessment

The FPMS requirement for the CFO certification specifies there should be a continuous assessment of financial reporting risk and controls throughout the financial year. Where departments use annual systems appraisals, the assessment process needs to be augmented with the use of other tools to achieve assurance throughout the financial year, unless the appraisal process involves selection of transactions over the period covered by the appraisal. A point-in-time appraisal significantly reduces the assurance obtained about the proper operation of internal controls over the entire period.

During 2012–13, controls were assessed annually by 13 departments, quarterly by two departments, and each month by four departments. One department does a combination of monthly, quarterly and annual assessments.

Follow up of control weaknesses

Where internal control weaknesses are identified, they need to be rectified in a timely manner to ensure that the risk of material financial statement error is mitigated. All departments had practices in place to follow up significant control weaknesses identified during the assessment process.

Quality assurance over the process

The methods selected to obtain the necessary level of assurance for the CFO certification need to be reviewed and tested for their effectiveness. It is important that it does not become a tick the box exercise.

All departments had an assigned officer responsible for collating and reviewing the quality of the evidence obtained for the CFO certification.

Divisional management assurances

Divisional management representations become an essential method of obtaining assurance where the operations of the department are decentralised, geographically or otherwise. These representations are made on the adequacy of the controls in place in the various divisions or locations of the department; for example, the chief information officer of a department may provide a certification on the proper operation of the information technology general controls.

Sixteen departments relied on divisional management assurances, but they also used alternative sources of information; for example, internal control questionnaires, discussions within divisions and internal audit reports to strengthen overall assurance about controls.

External service provider assurances

The CFO is responsible for assessing the appropriateness of the assurance provided by external service providers, principally Queensland Shared Services (QSS).

One assurance technique is obtaining a ‘comfort letter’, or similar representation, from the service provider that it has established and maintained appropriate controls to ensure accurate and timely processing by the provider. The CFO should assess the comfort letter to determine whether sufficient detail is provided to enable an assessment of the exact nature and extent of the assurance being provided and the effect of this assurance on the control environment of the agency.

If internal control issues are identified at the service provider, the CFO should undertake further testing to ensure the controls at the external service provider are reliable.

All departments received appropriately tailored assurances from their external service providers.

An example of a better practice case study is as follows:

Case study—Better practice application

Better practice application
The CFO uses the results of a combination of monthly, quarterly and annual assessments to support the conclusions drawn within their CFO assurance statement, providing comfort at a point in time and throughout the financial year. Participation through meetings with finance and other staff to discuss the outcomes of the wide variety of assessments provides the CFO with sound knowledge of the effectiveness of controls. Run the business checklists Process: as part of regular monitoring activities, units within the finance and procurement divisions of a department complete run the business checklists. Units providing checklists on key controls for their section include the areas of financial accounting, financial performance and systems, financial operations, facilities and accommodation services and the chief procurement office which are all integral to the internal control environment and financial reporting of the department. Frequency: the status of the run the business activities are updated and reviewed through discussion on a fortnightly basis between the CFO and the respective director/executive director for the unit, where progress and exceptions that have arisen during the period are discussed. Depending on the nature of the control activities managed by each unit, the review period may vary, with some being discussed on a monthly, quarterly or annual basis. **Control self assessments** Process: each business unit level completes control self assessments at least annually, based on sample testing throughout the financial year. Assessments include a review of key controls and processes that are integral to the functioning of the respective business unit. Results, including adverse findings and remedial action, are reported within the department's financial internal controls report that is presented in conjunction with the CFO's assurance statement when tabled annually at the audit committee meeting. Frequency: each branch operates its own control self assessment, based on risk. Completed at least annually, the reviews are carried out more regularly, depending on the risk. **Financial internal controls report** Process: activities undertaken during the financial year that form part of the department's internal control framework are outlined within this report. The results of the report underpin the CFO assurance statement to the accountable officer, assessing the internal control environment in terms of operational efficiency, effectiveness and economy throughout the financial year. **Other** • Internal control assessment project: initiated by the finance division, the project works to further enhance controls in the areas of payroll, accounts payable, accounts receivable, tax, general ledger and assets. This project is initiated as a direct result of the control issues encountered and the subsequent learnings that were recently gained by other departments. The improved controls have since been built into the department's control framework. • Taxation unit reviews: undertaken monthly, these include GST reasonableness reports, QSS transaction sampling and declaration reviews. • Financial system support reviews—SAP system security: process owner reviews over SAP user profiles are assessed quarterly; however, the frequency can increase where the risk level assigned is deemed significant. • Procurement governance self assessment checklist: developed by the Strategic Procurement Branch, the checklist enables divisions to assess their levels of compliance with departmental procurement procedures. • Financial delegations review: updates to delegations are undertaken quarterly. • QSS appraisal assessments: during the year, a number of internal control weaknesses were detected in the areas of payroll, general ledger and reporting, procurement, bank reconciliation and accounts receivable. This form of assessment has allowed the department to detect control issues early and to take corrective action in these areas.

2.7 Report form and content

The handbook prescribes the nature and extent of documentation and supporting evidence. It requires that the results of a CFO's assessments of internal control be clearly documented to ensure decisions are based on reliable data and provide a record of evidence that the statement provided by a CFO is factually based and robust.

It requires also that appropriate documentary evidence is available in the form of individual work papers or other documents, such as assurance statements provided by other areas of the agency or by an external service provider. The documentation should detail the processes and evidence relied upon to support the CFO’s decision to sign the statement.

There are various techniques and documentation styles for completing the documentation. However, the documentation should:

- enable a reasonably knowledgeable individual to understand the process
- provide context for the key controls so that a reasonable person would understand their function
- detail the operation of key controls such as identifying who is performing the control; when the control is operating and at what frequency; how the control is performed; what evidence exists that the control was performed; and which reports are used in the operation of the control.

Where specific controls are tested or verified, the handbook states that the CFO could identify:

- the nature of the controls assessed
- how they were assessed
- the results of the assessment
- the action taken or proposed to remedy a control breakdown or weakness.

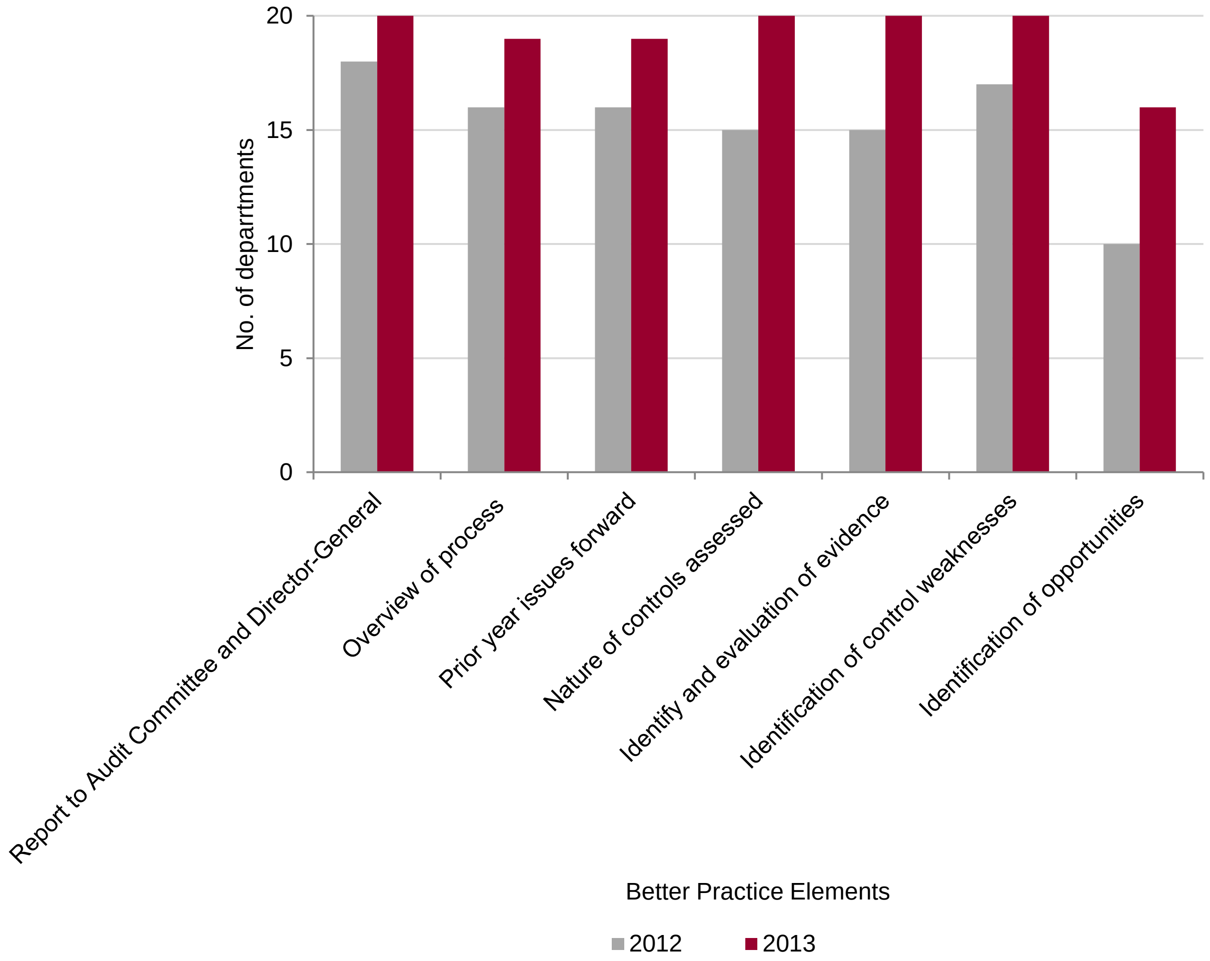
Where independent advice is obtained, including work undertaken by other areas of the department or by the internal audit function, the advice should be held with, or referenced by, the other documentation that supports the CFO’s certification.

To enable the Director-General to make a fully informed decision on the robustness of the CFO certification, the assurance statement itself should be accompanied by or included in a report with:

- an overview of the process used to arrive at the CFO's certification
- information on the nature of the controls assessed in the year under review
- identification and evaluation of evidence of the effectiveness of those controls identified
- identification of control weakness and an action plan to address these
- identification of opportunities to improve the CFO assurance statement process.

Figure 2C shows the number of departments that had included these suggested better practice elements in their reports.

Figure 2C
Better practice elements



Source: QAO

The analysis between 2011–12 and 2012–13 indicates an improved position for the departmental CFO certification reporting processes as the departments mature and strengthen their governance practices following the 2012 machinery of government changes.

3 Internal audit

In brief

Background

Internal audit plays an important role in monitoring internal controls.

Conclusion

The conceptual underpinnings required for effective internal audit functions are now in place in all departments.

In principle, with these precursors in place, all internal audit functions should be operating effectively. In practice, internal audit functions at eleven departments require improvement.

Key findings

- Departments have established adequate internal audit charters to outline their roles and responsibilities.
- Queensland Treasury and Trade (QTT) appointed its chief finance officer (CFO) as the head of internal audit (HIA).
- Departments are moving away from in house audit teams towards co-sourced and outsourced models.
- Internal audit budgets and staffing have decreased in 2012–13.
- Internal audit staff members are experienced and hold appropriate professional qualifications.
- Five departments internal audit functions are potentially under resourced based on their 2012–13 budgets.
- Planned internal audit work in 2012–13 had adequate coverage over fraud and information technology.
- Three departments have not performed an independent external assessment of their internal audit functions in the last five years.
- Rating internal audit findings and recommendations as high risk or priority 1 does not guarantee prompt implementation by management.

3.1 Background

The *Financial Accountability Act 2009* (FAA) requires the Director-General, as the accountable officer, to nominate a person to be responsible for the internal audit activities of the department. This person, the head of internal audit (HIA), is responsible for providing an assessment and evaluation of the effectiveness and efficiency of departmental financial and operational systems, reporting processes and risk management activities.

Volume 2 of the Financial Accountability Handbook (the handbook) issued by Queensland Treasury and Trade and last updated in November 2012 contains better practice guidance on the role of the head of internal audit. We also sourced better practices from the Better Practice Guide—Public Sector Internal Audit (the guide) published by the Australian National Audit Office (ANAO) in September 2012.

Since March 2012, the size and shape of departmental internal audit units have been affected by:

- machinery of government changes, with the number of departments increasing and functions and staff transferring between departments
- voluntary separation programs and voluntary employee redundancies
- the whole-of-government corporate services review through the public sector renewal program, which included internal audit services
- the advent of the principle of contestability across government.

As part of the machinery of government changes, the Directors-General of five departments determined they would establish a shared services model called the Queensland Government Internal Audit Service (QGIAS) applicable to:

- Department of Environment and Heritage Protection (DEHP)
- Department of Natural Resources and Mines (DNRM)
- Department of Agriculture, Fisheries and Forestry (DAFF)
- Department of Energy and Water Supply (DEWS)
- Department of Tourism, Major Events, Small Business and the Commonwealth Games (DTESB).

3.2 Audit objectives

In the light of the changes since 2012, we examined internal audit effectiveness across all departments and assessed how internal audit functions compare against recognised better practice.

To assess their effectiveness across the 20 departments, we examined whether, during 2012–13, internal audit functions:

- were underpinned by sound operating principles
- were adequately resourced by professionally qualified and suitably experienced staff
- were planned well and completed their approved work programs as intended
- had sufficient coverage over high risk areas of fraud and information technology
- were rigorously evaluated.

3.3 Conclusions

The conceptual underpinnings required for effective internal audit functions are now in place in all departments, with comprehensive charters governing their establishment and operations; and all departments have access to resources that are suitably experienced, qualified and independent of the organisations.

In principle, with these precursors in place, internal audit functions should be operating effectively. In practice, internal audit functions at eleven departments require further improvement.

3.4 Findings summary

All 20 departments have an internal audit function. If the functions are to be effective:

- the position of internal audit within each department's governance framework and the role it plays must be well defined, appropriate to the assurance needs of the department and must allow effective discharge of internal audit responsibilities
- they must be adequately resourced through their budgets and have access to necessary skills and experience
- they should have robust planning processes to focus their activities on the department's risks and priorities
- the performance needs of the internal audit position should be assessed periodically so opportunities for improvement are identified and addressed
- the recommendations of the function should be implemented within the time frames suggested by internal audit and agreed by management.

Figure 3A summarises the departments with elements for improvement.

Figure 3A
Departments with elements for improvement

Element	Departments	Findings for 2012–13
Operating principles	QTT	Independence may be compromised due to the HIA also being the CFO
Resourcing	DATSIMA, DLGCRR, QPS, DEWS, DoH	The internal audit function may be under resourced, based on the 2012–13 budget
Audit plans	DCS	No formal audit work plan was established
Performance	DCCSDS, DCS, DHPW	Independent external assessment of the internal audit function has not been conducted within the last five years
Recommendations	DCCSDS, DETE, DJAG, DCS	High number of outstanding internal audit issues which are assessed as high risk or priority one

Source: QAO

3.5 Operating principles

Internal audit is an integral part of the internal control framework that departments establish to manage their risks and achieve their objectives. It is important that the position of internal audit in this governance framework and the role it plays is well defined, is appropriate to the particular assurance needs of the department and allows effective discharge of its responsibilities. In this section, we examine the adequacy of the content of the departments' internal audit charters and the independence of their internal audit functions.

3.5.1 Internal audit charters

The internal audit charter documents internal audit's role, responsibilities, authority, standards and accountabilities and defines the position of internal audit in the entity's governance framework. Development of the charter is an important means of understanding and clarifying stakeholder needs and expectations.

We assessed the contents of the departments' internal audit charters against the ANAO's better practice guide.

The internal audit charters of the Department of the Premier and Cabinet (DPC) and the QGIAS meet the better practice guidelines. The other departmental charters satisfactorily address the key aspects of a better practice internal audit charter, including scope and purpose, independence, roles and responsibilities, authority, competence and standards, conduct of work, planning, reporting and relationship with external audit.

Some charters can be improved by providing for:

- the process for changes to the position of HIA
- periodic, independent external assessments of the internal audit function
- periodic reviews of the charter and the process for such review.

3.5.2 Independence

A defining feature of a better practice internal audit function is its operational independence. Only by being independent from the areas that are subject to audit can the function of internal audit act in an objective and impartial manner that is free from any conflicts of interest, inherent bias or undue external influence in the conduct of its audits.

This independence is achieved by:

- independence from operational functions and processes
- having a direct line of reporting to the Director-General
- not being primarily responsible for the development of internal control processes or systems but being consulted on significant changes to existing systems or introduction of new systems
- the HIA not having management responsibilities in areas subject to audit.

All but one department meet these independence guidelines. The internal audit function of Queensland Treasury and Trade (QTT) was outsourced to an external accounting firm in 2012–13 and the chief finance officer (CFO) of QTT had been nominated as the HIA. The nomination of the same person as both the CFO and HIA effectively sees this person responsible for implementing financial internal controls and for assessing financial internal controls independently. This creates a self review threat and an independence issue for the internal audit function.

The possible nomination of a CFO as the HIA is considered in the handbook in Volume 2 IS 2.6 Head of Internal Audit under the heading 'Alternatives to appointing an internal HIA'. The information sheet identifies that the nomination of the CFO as the HIA is not an ideal solution and should only be considered in '*exceptional circumstances after all possible alternatives have been assessed as not viable*'. Considering the size of QTT, the existence of 'exceptional circumstances' to necessitate this arrangement is not evident.

Apart from his or her perceived and actual independence, it is not clear that one officer has the capacity to discharge effectively the delegated responsibilities of both the CFO and HIA in sections 77 and 78 of the FAA. These responsibilities need to be given an appropriate level of attention by the nominated officers and the roles of CFO and HIA should not be seen as mere figureheads.

3.6 Resources

It is important that the internal audit function has an adequate budget and has access to the necessary skills and experience to provide the Director-General with the timely and quality services expected of the function. In this section, we examine the adequacy of internal audit resourcing by considering the departments' 2012–13 internal audit budgets and the qualifications and experience held by internal audit staff.

3.6.1 Sufficiency of internal audit resources

Sourcing strategies

Figure 3B illustrates the shift in strategies adopted in resourcing the internal audit function, showing the number of departments using each model in April 2012 before machinery of government (MoG) changes and in June 2013 after MoG changes.

Figure 3B
Internal audit sourcing strategies

Resourcing model	April 2012	June 2013
In house	11	8
Supplied by another department's HIA	—	2
Supplied by bureau service (QGIAS)	—	5
Co-sourced, primarily in house	2	3
Outsourced	—	2
Total	**13**	**20**

Source: QAO

Major changes in internal audit resourcing since the 2012 MoG changes have been:

- the establishment of the Queensland Government Internal Audit Service (QGIAS) bureau providing internal audit services to five departments. These five departments, called the QGIAS departments in this report, are:
  - Department of Environment and Heritage Protection (DEHP)
  - Department of Agriculture, Fisheries and Forestry (DAFF)
  - Department of Energy and Water Supply (DEWS)
  - Department of Natural Resources and Mines (DNRM)
  - Department of Tourism, Major Events, Small Business and the Commonwealth Games (DTESB)
- DPC and QTT disbanded their in house internal audit functions and moved to fully outsourced models.

Queensland Police Service, which had an in house internal audit function in 2012–13, will move to an outsourced model in 2013–14.

On average, departmental in house internal audit staff numbers decreased by 42 per cent compared to 2011–12. This was due to a combination of voluntary redundancy and separation packages and moving from in house internal audit to outsourced arrangements.

Internal audit budgets

It is important that the internal audit function has an adequate budget which allows for access to necessary skills and experience. On average, there was a decrease of 31 per cent in departmental internal audit budgets for 2012–13, compared to 2011–12.

The move away from in house sourcing models by departments coincided with reduced resourcing of internal audit. Departments which retained their in house internal audit functions recorded an average decrease of 22 per cent in resources. The decrease to internal audit resources in the departments which have adopted an alternate sourcing strategy averaged 35 per cent.

The most significant reductions in internal audit budgets were seen at:

- DPC with a decrease of 71 per cent, in line with a significant reduction in the size of the department
- Department of Health (DoH), with a decrease of 51 per cent consistent with the separation from the department of the 17 Hospital and Health Services which each established its own internal audit unit
- six departments drawn primarily from the former Department of Environment and Resource Management (DERM) and Department of Employment, Economic Development and Innovation (DEEDI), with an overall decrease of 34 per cent—the departments comprised:
  - Department of Environment and Heritage Protection (DEHP)
  - Department of Agriculture, Fisheries and Forestry (DAFF)
  - Department of Energy and Water Supply (DEWS)
  - Department of Natural Resources and Mines (DNRM)
  - Department of National Parks, Recreation, Sport and Racing (DNPRSR)
  - Department of Tourism, Major Events, Small Business and the Commonwealth Games (DTESB).

There was an increase in the internal audit budget of the former Department of Public Works where the internal audit unit split to become internal audit units of the Department of Housing and Public Works (DHPW) and the Department of Science, Information Technology, Innovation and the Arts (DSITIA). The overall increase was 56 per cent. The MoG changes saw DHPW gaining housing and homelessness services and DSITIA gaining a number of areas from DPC, DEEDI and DERM.

Benchmarking of internal audit resourcing

One measure of the adequacy of internal audit resourcing is the cost of internal audit as a percentage of total operating expenditure. We compared the 2012–13 internal audit budgets, obtained from each department, against the departments' 2012–13 total expenditure budgets from the Service Delivery Statements. We used total expenditure budget figures that included controlled departmental expenditure and expenditure of commercialised business units.

The optimal percentage for an individual department varies, depending on the size and scale of its operations. It will also vary with matters such as complexity and risk which are not necessarily reflected in total expenditure. For this reason, the benchmarks we use in this report are indicative only and need to be further contextualised by each department to its own circumstances.

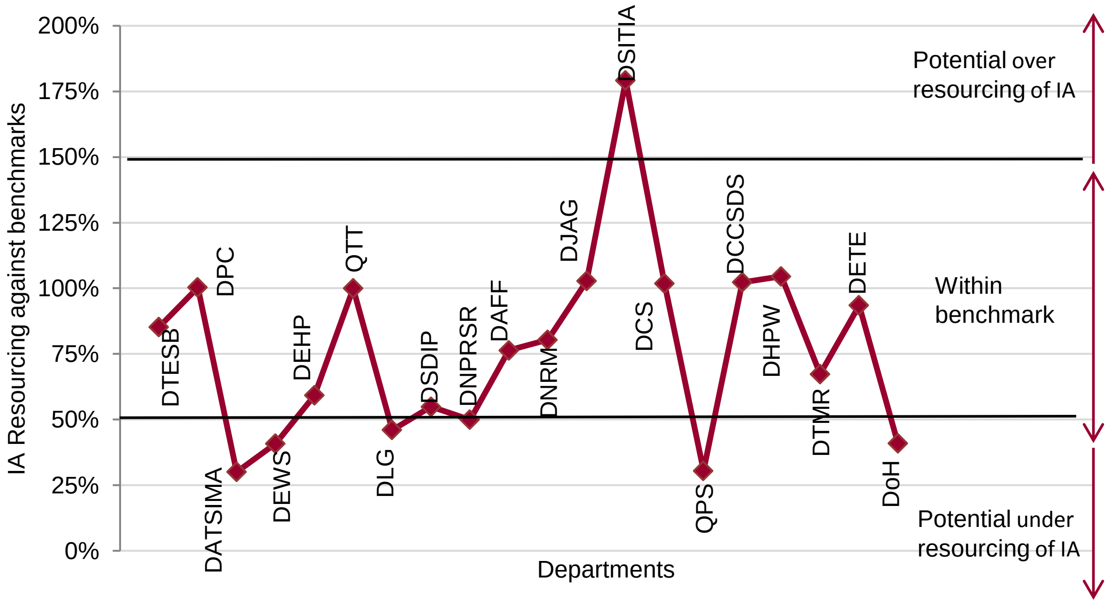
The results in this report are provided for internal audit and audit committees to consider in conducting their own external benchmarking that assesses the adequacy of their internal audit resourcing.

Across the 20 departments, the average internal audit budget as a percentage of total operating expenditure is 0.128 per cent.

Our benchmarking model is calibrated so that a department with higher total expenditure would have a lower benchmark percentage. This reflects factors such as the economies of scale that can be achieved in larger organisations, but which are not available to smaller agencies. Our indicative benchmark starts therefore at 0.35 per cent for small departments like DTESB and DPC and gradually scales down to 0.05 per cent for large departments like DoH.

Figure 3C shows the 20 departments' level of internal audit resourcing in 2012–13 compared to our calibrated benchmarks.

Figure 3C
Level of internal audit resourcing against benchmarks



Note: the departments in Figure 3C are ordered from smallest (DTESB) to largest (DoH) in terms of total budgeted expenditure.

Source: QAO

Analysis of each department's internal audit budgets reveals that, overall, they were 23 per cent lower compared to our benchmarks. Five departments' budgets are significantly lower than our benchmarks (less than 50 per cent), being:

- Department of Aboriginal and Torres Strait Islander and Multicultural Affairs (DATSIMA)
- Department of Energy and Water Supply (DEWS)
- Department of Health (DoH)
- Department of Local Government, Community Recovery and Resilience (DLGCRR)
- Queensland Police Service (QPS).

We noted that QPS had been winding down its in house internal audit function in 2012–13, for a move to an outsourced model in 2013–14; however, it had a similar level of internal audit resourcing in 2012–13 compared to 2011–12, with a decrease of only two per cent since last year.

The other departments with potentially under-resourced internal audit functions had larger decreases in their internal audit budgets in 2012–13 and, therefore, may have had adequate internal audit resourcing in the prior year. We are unable to perform a conclusive comparison with 2011–12, due to the extent of the MoG changes and that the new departments which have gained and lost various functions are not directly comparable with their former counterparts.

We also note that the range and complexity of the services provided by DSITIA may add to the need for extra internal audit resources to cover the associated risks.

Staffing

For the 10 departments with primarily in house internal audit functions, we compared the number of full time equivalents (FTEs) in internal audit to total FTEs in the department. The average across the 10 departments is 0.18 per cent or about 556 staff per internal auditor. We included departmental staff and staff of commercialised business units in our calculations. Overall, we found results consistent with our internal audit budget analysis.

Queensland Government Internal Audit Service (QGIAS)

The QGIAS is a centralised corporate services arrangement established for departments formed predominately from the former departments of Department of Environment and Resource Management (DERM) and Department of Employment, Economic Development and Innovation (DEEDI), following the 2012 machinery of government changes.

The QGIAS provided internal audit services from April 2012 to a cluster of six departments:

- Department of Agriculture, Fisheries and Forestry (DAFF)
- Department of Energy and Water Supply (DEWS)
- Department of Environment and Heritage Protection (DEHP)
- Department of National Parks, Recreation, Sport and Racing (DNPRSR)
- Department of Natural Resources and Mines (DNRM)
- Department of Tourism, Major Events, Small Business and the Commonwealth Games (DTESB).

The Treasurer approved that the HIA employed by DEHP perform the role for the other departments.

Prior to December 2012, the QGIAS focused on the finalisation of internal audit reviews from the former DEEDI and DERM and on supporting its own establishment and the formation of audit committees of the departments within the cluster. The QGIAS has also performed data mining which may assist those in charge of governance and external audit to gain assurance over cluster systems.

In February 2013, DNPRSR withdrew from this arrangement. An agreed budget and staff were transferred from DEHP to DNPRSR to establish its own internal audit unit.

Our overall assessment of the QGIAS resourcing arrangement and its effectiveness as an internal audit function for the five departments is that there is a proper framework in place and the internal audit team is objective and competent.

3.6.2 Competence of internal audit resources

Possession of professional qualifications demonstrates the internal auditor's commitment to competency and professionalism in his or her work and to ongoing professional development. We examined the qualifications and audit experience of in house internal auditors to gauge the appropriateness of internal audit resourcing.

Overall, in house internal audit staff members across the 20 departments are adequately experienced and have appropriate and relevant qualifications for their positions.

We considered the following factors in our assessment of qualifications and experience:

- whether the HIA is a member of the Institute of Internal Auditors (IIA) and/or holds an appropriate qualification conferred by a professional accounting body (ICAA, CPA Australia or IPA)
- whether information systems auditors have Certified Information Systems Auditor (CISA) qualifications from ISACA
- whether senior internal auditors (AO6 level and above) have membership of the IIA, a professional accounting body and/or ISACA, or are undertaking studies to attain such qualifications
- whether internal auditors hold a university degree in a field relevant to their position
- the average number of years of audit experience of internal audit staff.

We found that:

- all HIAs meet the requirements of section 5 of the Financial Accountability Regulation 2009 by holding membership of the IIA and/or a professional accounting body
- 95 per cent of information systems auditors are CISA qualified
- 86 per cent of senior internal auditors hold a professional qualification from the IIA, a professional accounting body or ISACA—those who do not have such qualifications are mostly field experts, who hold relevant degrees and qualifications in their specific fields, such as law, tourism, quality management and engineering
- 99 per cent of internal auditors hold a university degree or equivalent that is relevant to their positions
- the average years of audit experience possessed by in house internal auditors across the departments is 12 years.

Where internal audit functions or services were contracted out to the private sector, the departments have engaged reputable accounting firms with qualified and experienced staff.

3.7 Audit plans

Better practice internal audit functions use a robust audit planning process to align their focus and activities to the department's risks and priorities. In this section, we examine whether internal audit plans were approved on a timely basis, the criteria considered by internal audit in their audit topic selection process and whether there has been adequate internal audit coverage over information technology and fraud in 2012–13.

3.7.1 Approval

The *Financial and Performance Management Standard* 2009 (FPMS) requires the preparation of an annual internal audit plan appropriate to the size and functions of the department, setting out the audits to be carried out during the year. The plan is to be approved by the Director-General, based on the recommendation of the audit committee. Ideally annual internal audit plans are approved before the start of the year to which they relate.

Nineteen of the 20 departments had a current plan, the Department of Community Safety (DCS) being the exception. Due to the extent of external reviews and internal restructuring, DCS did not adopt an annual internal audit plan for 2012–13. Instead, internal audit engaged with senior departmental executives in ongoing consultation to identify areas where internal audit could add value.

There were two audit plans for the QGIAS departments, including a six-month bridging program covering 1 July 2012 to 31 December 2012 that was approved in July 2012 and a second plan approved in February 2013 for the remainder of the year.

The reasons for two audit plans being used included:

- as a co-sourced model of service delivery is used, time was necessary to appoint and mobilise the contractor
- the initial plan was developed on a calendar year basis, rather than a financial year basis
- the new corporate partnership shared delivery model for internal audit services necessitated determining the audit risk areas
- there were delays in the partnership agreeing to the audit risk areas and which particular proposed audit projects were to be undertaken for particular departments
- there were disagreements within the corporate partnership regarding the level of funding to the QGIAS, which resulted in protracted negotiations about what budgets were available to undertake the audits.

3.7.2 Audit topic selection

Development of the annual audit plan involves a process of assessment, selection and ranking of potential audit topics. A wide range of factors and criteria are considered in this process. We considered a set of criteria from the ANAO's better practice guide in our assessment of the departments' internal audit topic selection process. These criteria comprised:

- risks identified in the department's risk management plans or risk register
- the importance of the program or activity to the department's objectives
- coverage to support external reporting obligations of the department
- the potential or expected benefits of the audit
- specific requests from management
- findings from previous audits or reviews
- relevant reports and recommendations from parliamentary committees
- length of time since any previous internal or external audit.

Fifteen of the 20 departments had covered the majority of the better practice criteria; however, criteria which were considered by less than half the departments were:

- the potential or expected benefits of the audit
- relevant reports and recommendations from parliamentary committees
- length of time since any previous internal or external audit.

There are processes in all departments for the review and update of audit plans throughout the year, usually during audit committee meetings. This allows internal audit resources to be redirected to meet new priorities and audits can be added in response to new risks or issues that may arise.

3.7.3 Coverage of information technology and fraud risks

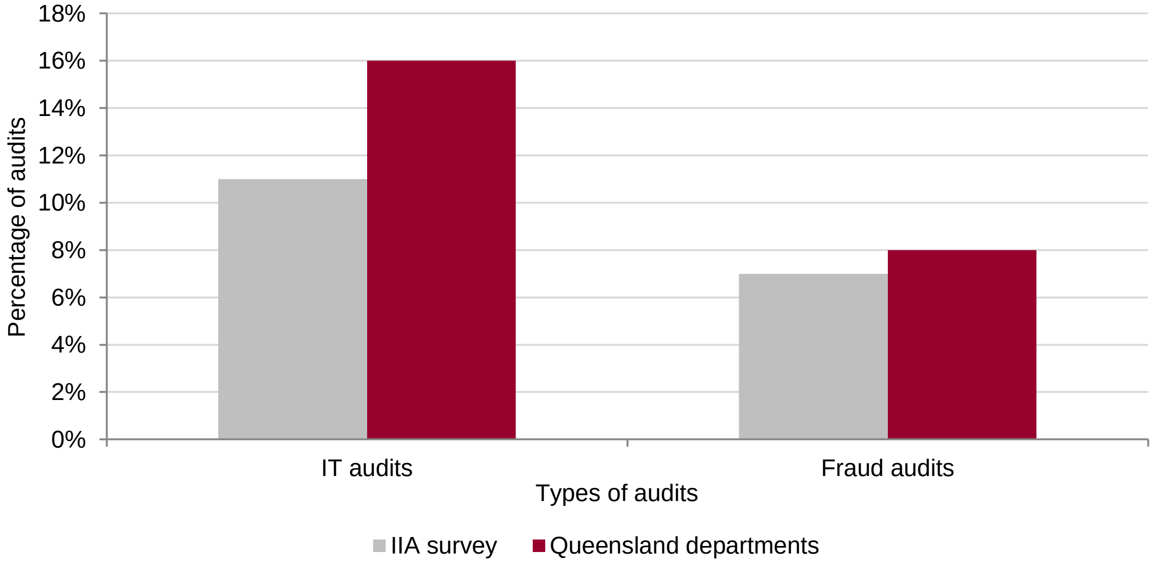
The extent of reliance on information technology contributes significantly to the risks of the departments. A comprehensive internal audit work plan should include audits of major information technology systems. Internal audit can also add value by developing and using computer programs to analyse financial and other data to detect any unusual transactions or trends which could reveal fraud or error.

We benchmarked the percentage of information technology and fraud audits in the departments' internal audit plans to the results of the Institute of Internal Auditors (IIA) survey *Achieving High Performance in Internal Audit*, 5th Edition, 2013. This survey collected internal audit statistics of listed and unlisted private companies, government entities, not for profit entities and service providers of varying sizes.

Our benchmarking is based on our interpretation of the types of work in departments' 2012–13 annual audit plans compared to the description of work in the IIA survey and should not be regarded as conclusive. This comparison is made only to gauge the reasonableness of the information technology and fraud coverage. Each individual internal audit unit should carry out its own analysis for presentation to its audit committees.

Figure 3D shows the percentage of fraud audits and information technology audits from the IIA survey and from our analysis of the departments' annual work plans. Overall, the percentage of fraud audits is in line with IIA findings—8 per cent compared to 7 per cent, and the departments performed more information technology audits than the survey result—16 per cent compared to 11 per cent.

Figure 3D
Percentage of information technology and fraud audits in annual audit plans



Source: QAO

Findings from individual departments' audit plans were:

- while all 20 departments covered at least some aspects of fraud in their audit plans, two of 20 departments had less than the IIA benchmark of 7 per cent fraud coverage (i.e. they had less than 3.5 per cent coverage)
- five of the 20 departments had 22 per cent or more coverage in information technology audits.

The majority of departments are using their internal audit functions adequately to address fraud and information technology risks. Internal audit units should ensure that their focus on information technology is in line with the risks and priorities of the department and does not result in diminished oversight of other key operational areas.

3.8 Performance of internal audit

Periodically assessing the performance of internal audit and addressing opportunities for improvement can help maximise the efficiency and effectiveness of the internal audit function. We examined the key performance indicators (KPIs) used by the departments to measure performance of their internal audit units, and whether periodic external assessments of the internal audit function have been conducted as required by the IIA's professional standards.

3.8.1 Performance measurement and evaluation

Regular performance evaluations of the internal audit function ensure that internal audit is held accountable for its use of resources and delivery of service improvements. Better practice indicates that these performance evaluations should not be limited to the assessment of the program of an internal audit unit against its audit work plan.

We considered the KPIs in the ANAO's better practice guide to establish whether the departments are adequately measuring the performance of their internal audit functions. The better practice KPIs we used are:

- cost of internal audits commensurate with the objectives or benefits of the audit
- acceptance of recommendations made by internal audit
- quality of internal audit services
- stakeholder satisfaction
- progress in delivery of the approved program
- internal audit staff qualifications and professional development
- internal audit staff satisfaction
- overall contribution made by the internal audit function.

Seven of 20 departments have adopted more than half of these KPIs in their performance evaluations; in particular, DETE and DSITIA used all of the better practice KPIs.

KPIs which were least used are:

- the internal audit staff qualifications and professional development
- the timeliness and cost of internal audits commensurate with the objectives or benefits of the audit
- the acceptance of recommendations made by internal audit
- the overall contribution made by the internal audit function.

3.8.2 External assessment

The IIA's International Standards for the Professional Practice of Internal Auditing require an external assessment of internal audit function to be conducted at least once every five years by a qualified independent person or team from outside the organisation. As well as providing quality assurance over internal audit work, the external review allows an objective evaluation and scrutiny of all aspects of the internal audit function—including the service delivery model, internal audit strategy, its value to the organisation and efficiency and effectiveness of the unit—to identify areas where processes and outcomes can be improved. The review can include benchmarking internal audit performance against similar organisations.

New departments arising from the machinery of government changes in 2012 whose internal audit functions have only recently been established were excluded from our review.

Three of the departments with continuing internal audit units have not conducted an external assessment within the last five years. These are presented in Figure 3E, together with the years of their last external assessments.

Figure 3E
Departments without external assessments in the last five years

Department	Year of last external assessment
DCCSDS	2007 (under the former Disability Services Queensland and Department of Communities)
DCS	2005 (under the former Department of Emergency Services)
DHPW	2005–06 (under the former Department of Public Works)

Source: QAO

3.8.3 Implementation of internal audit recommendations

The recommendations of internal audit agreed by management should be implemented in the recommended time frames so internal audit is effective at strengthening internal controls.

Significant internal audit findings and related recommendations are typically rated by internal audit as high risk/priority 1 or medium risk/priority 2. High risk audit recommendations are defined as those that require urgent action to correct or improve internal controls and to reduce the risk to the department.

Figure 3F shows recommended better practice implementation time frames for internal audit recommendations. Where recommendations involve a long lead time to implement fully, it is better practice that the action plan and time frame are broken up into stages.

Figure 3F
Better practice implementation time frames

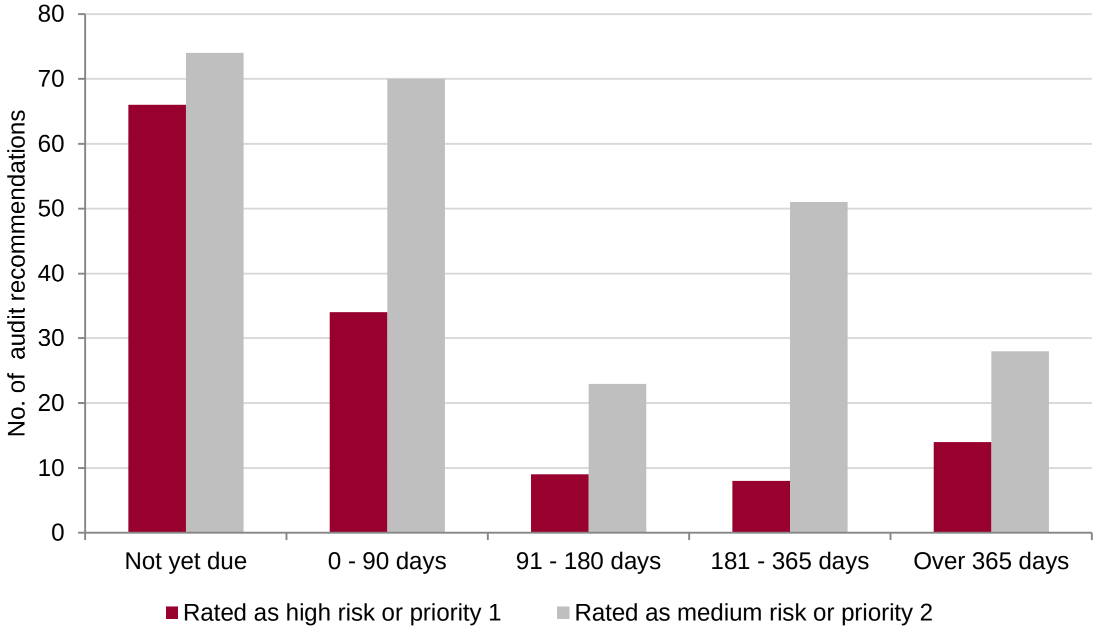
Risk exposure category	Implementation time frame
High risk	Within one to three months
Medium risk	Within three to six months
Low risk	Within six to 12 months

Source: Australian National Audit Office—Public Sector Internal Audit Better Practice Guidelines

Departmental structural changes and the shift from in house internal audit functions to outsourced and co-sourced models have increased the risk that past internal audit recommendations may have been overlooked or are no longer relevant. We reviewed the departments' open recommendations at 28 February 2013.

Figure 3G shows the number of accepted but unfinalised internal audit recommendations.

Figure 3G
Accepted internal audit recommendations not finalised at February 2013



Source: QAO

The time taken to act on internal audit recommendations can be an indicator of the attitude of management to internal audit and its perceived value to the organisation.

Of the 264 total overdue recommendations at 28 February 2013, 65 recommendations (25 per cent) were high risk and 172 recommendations (65 per cent) were medium risk: 31 of the 65 high risk recommendations had been outstanding for more than three months and 14 were more than 12 months old.

Departments with a high number of outstanding high risk recommendations at that time were:

- Department of Community Safety
- Department of Education, Training and Employment
- Department of Communities, Child Safety and Disability Services
- Department of Justice and Attorney-General.

The reasons provided by management for the delays in finalising these high risk recommendations include not having the funds available to pay for changes, additional work or projects needing to be completed or not having the staff available to perform the necessary work.

Departmental audit committees and management need to re-assess all unfinalised accepted recommendations to determine whether:

- recommendations are still relevant
- risk ratings assigned are still accurate
- the organisational response on their implementation has been adequate
- any long outstanding matters create an unacceptable risk to the department if timely action is not taken.

Case study—focusing internal audit to meet strategic objectives

Focusing internal audit to meet strategic objectives
Strategic alignment The department recognised that, in the context of a challenging funding environment and changing risk profiles, the audit and assurance activities needed to be better aligned with the strategic direction of the department. To achieve this aim of strategic alignment, a review was conducted that considered the department's current strategic objectives mapping the Internal Audit Branch strategic and operational plans and the annual audit plan against those objectives. Alignment with the risk management framework, optimising the controls framework and understanding various service delivery models were included as an integral part of the review. **Controls optimisation** A significant issue in the review was controls optimisation. High inherent risks were identified where there was a low tolerance to ensure resources for controls are focused in these areas. Significant opportunity was noted for control, process and operational improvements, leading to more cost effective controls. The review found that 15 per cent of controls were automated compared to industry benchmarks of 20 to 30 per cent with 45 per cent of controls being detective. The work completed allowed both internal audit and management to gain a good understanding of the control environment as a starting point for where effort should be directed for improved practices. **Service delivery models** Recognising that the internal audit service could be delivered through an in house function, outsourcing or co-sourcing the key areas were examined to identify the best fit for each of the activities. A robust analysis led to a conclusion that a co-sourced model should be adopted. In association with this exercise, an assessment of staff capability was conducted. **Performance measurement and assessment** Critical to the review was the benchmarking of the internal audit function against the Global Audit Information Network (GAIN) criteria related to stakeholder engagement (management and audit committees), audit process and performance and staffing. The results of the assessment provided management and internal audit with important information on which to make decisions about the internal audit size and budget.

4 Audit committees

In brief

Background

Audit committees are an important part of the governance framework of public sector entities. They provide an independent source of assurance and advice to the Director-General about internal financial controls.

Conclusion

Departmental audit committees have been established with comprehensive charters to govern their ongoing operations; they hold regular meetings to monitor the internal control environment; and they documented proceedings adequately.

In principle, all the committees should be operating effectively. In practice, audit committee operations at six departments require improvement in their operating principles, committee structure and key responsibilities.

Key findings

Operating principles

- One department audit committee did not have an annual work program in place and had not commenced an annual review of its charter as it was awaiting the results of an ongoing external review.

Committee structure

- The average audit committee membership was six, which is the maximum recommended in Queensland Treasury and Trade's Audit Committee Guidelines: Improving Accountability and Performance (the guidelines). Eight department audit committees had membership numbers that exceeded this maximum.
- One department audit committee had no external members and five audit committees had the department's Director-General as the chair.
- Fourteen department audit committees had external, independent membership of less than 50 per cent which is in contrast to the Under Treasurer's request encouraging a long term strategy of appointing more independent members so that, ideally, at least half of the membership is independent.

Key responsibilities

- Chapter 3 of this report noted eleven departments as having internal audit functions with elements for improvement which may affect the extent of internal control assurance provided to an audit committee.
- Two departments that have an audit committee with membership in excess of the maximum recommended size and low external member representation also had long outstanding high risk internal audit issues awaiting resolution.

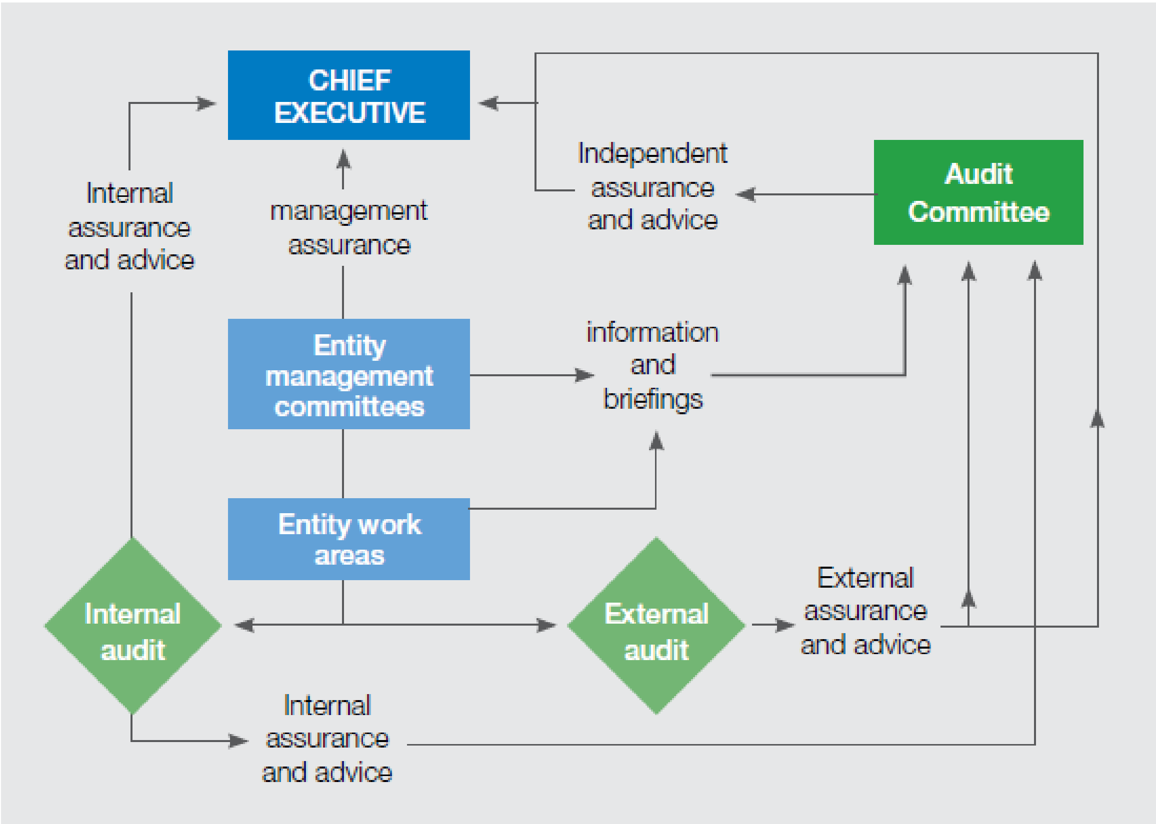
4.1 Background

The requirement to establish departmental audit committees is governed by the Financial and Performance Management Standard 2009 (FPMS). Queensland Treasury and Trade also issues guidelines on governance and audit committee operation. Its guidelines intend to combine best practice principles identified in a number of best practice guidelines for audit committees in both the public and private sectors.

An audit committee is recognised internationally as a key element of good governance; an effective audit committee provides a Director-General with added confidence in a department's financial reporting, internal controls, risk management, legislative compliance and audit functions.

Figure 4A shows the typical relationships between the audit committee, the entity and its external auditors as part of the overall accountability framework.

Figure 4A
Overview of a typical accountability framework of an entity



Source: Australian National Audit Office

4.1.1 Better practice

Under the better practice guidelines, audit committees should have a clearly documented charter that has been determined with regard to relevant legislative requirements and the department's broader corporate governance framework—including the committee's responsibilities—and which is approved by the Director-General. Committees should also plan their activities to meet their responsibilities; focus on the important issues and risks; be forward looking; and adopt a continuous improvement approach in interactions with department management.

Audit committees should be chaired by a person who is able to lead discussions, encourage the participation of other members and conduct meetings in an effective manner. The membership of each committee should comprise individuals with the right combination of skills and experience so that the group possesses broad business, financial management and public sector experience and expertise. These individuals need to be knowledgeable about the entity's operations, particularly the department's risks and the arrangements in place for the management of these risks.

The members of an effective audit committee receive appropriate levels of support and sufficient opportunities to keep abreast of key developments in the department and the public sector generally. This includes being provided with an appropriate agenda and supporting materials in sufficient time to ask challenging questions and fulfil the audit committee charter responsibilities.

An audit committee should have a sound working relationship with the Director-General and be able to exercise discretion in determining how best to meet its responsibilities. This includes adopting an independent perspective which separates management and audit committee responsibilities.

The committee members should encourage and maintain open and constructive dialogue with senior management, internal and external audit and other committees. Holding separate sessions with auditors and management is also conducive to achieving the financial oversight responsibilities and obtaining feedback for annual self assessment.

Effective audit committees monitor the implementation of recommendations made by internal and external audit and other review activities. They ensure that internal audit coverage is aligned with a department's risks; is an appropriate mix of performance and compliance audits; and includes a focus on the areas of greatest risk.

4.2 Audit objectives

As part of our annual financial audit, we routinely assess the role and effectiveness of each department's audit committee as part of our consideration of the control environment. An effective audit committee strengthens the control environment, which is the foundation for the other components of internal control.

To form a positive conclusion on the effectiveness of an audit committee, we expect to find the application and demonstration of the five key elements contained in the audit committee guidelines— operating principles, committee structure, key responsibilities, relationship with audit and proceedings— taking into consideration the industry and associated risk environment in which the department operates.

4.3 Conclusions

Departmental audit committees have been established with comprehensive charters to govern their ongoing operations; they hold regular meetings to monitor the internal control environment; and they documented proceedings adequately.

In principle, all the committees should be operating effectively. In practice, audit committee operations at six departments require improvement in their operating principles, committee structure and key responsibilities.

Two of these six audit committees had memberships larger than average and recommended numbers, low external member representation and long outstanding high risk internal audit issues awaiting resolution. The combination of these factors raises concerns about their operating effectiveness.

Fourteen department audit committees had independent, external membership of less than 50 per cent; which is in contrast to the Under Treasurer request encouraging a long term strategy of appointing more independent members so that, ideally, at least half of the membership is independent. Where there is a predominance of management representation on the committees, there is a higher risk of conflict of interest.

4.4 Findings summary

All departments were assessed as satisfactory for their relationship with audit and for the standard of evidence of their proceedings. Figure 4B shows the departmental audit committees assessed as less than satisfactory for the three other elements, noting the areas which can be improved.

Figure 4B
Departments with elements for improvement

Department	Operating principles	Committee structure	Key responsibilities
DCS	Annual review of charter yet to commence No annual work plan	No external members Director-General is chair	Long outstanding high risk internal audit issues
DEHP		Director-General is chair	
DJAG		Three more members than than desirable maximum size	Long outstanding high risk internal audit issues
DNPRSR		Director-General is chair	
DNRM		Two more members than desirable maximum size Director-General is chair	
DTESB		Director-General is chair	

Source: QAO

4.5 Operating principles

Audit committees should underpin their operations with a robust charter and comprehensive annual work plan. An approved charter creates clear accountability by documenting the committee's purpose, responsibilities, processes to perform responsibilities, committee membership and performance assessment. It should also distinguish the committee's activities from the Director-General's responsibilities.

4.5.1 Audit committee charter

All departmental audit committees had charters that were largely consistent and considered appropriate for undertaking their key responsibilities as a governance committee; however, there were opportunities identified to enhance their charter and operational capability. Such opportunities include incorporating specific comment within the audit committee charter of ten of the departments to address induction of new members; and, for 14 departments, how the self-assessment of the audit committee is to be undertaken.

4.5.2 Annual work plan

An annual work plan outlines the activities that are to be covered at audit committee meetings during the year. The Department of Community Safety audit committee did not have an annual work program for 2012–13. Without a plan, the audit committee cannot demonstrate its accountability for considering and addressing all key topics during the year.

4.6 Committee structure

Audit committees need the right balance of skills and industry experience so members challenge management appropriately and provide impartial views. Audit committees should have members who can ask probing questions of management and auditors and have a value adding relationship with management where audit committee expectations are understood and actions requested are carried out.

For this to occur, members need financial management and public sector governance experience, industry knowledge and the competency to oversee:

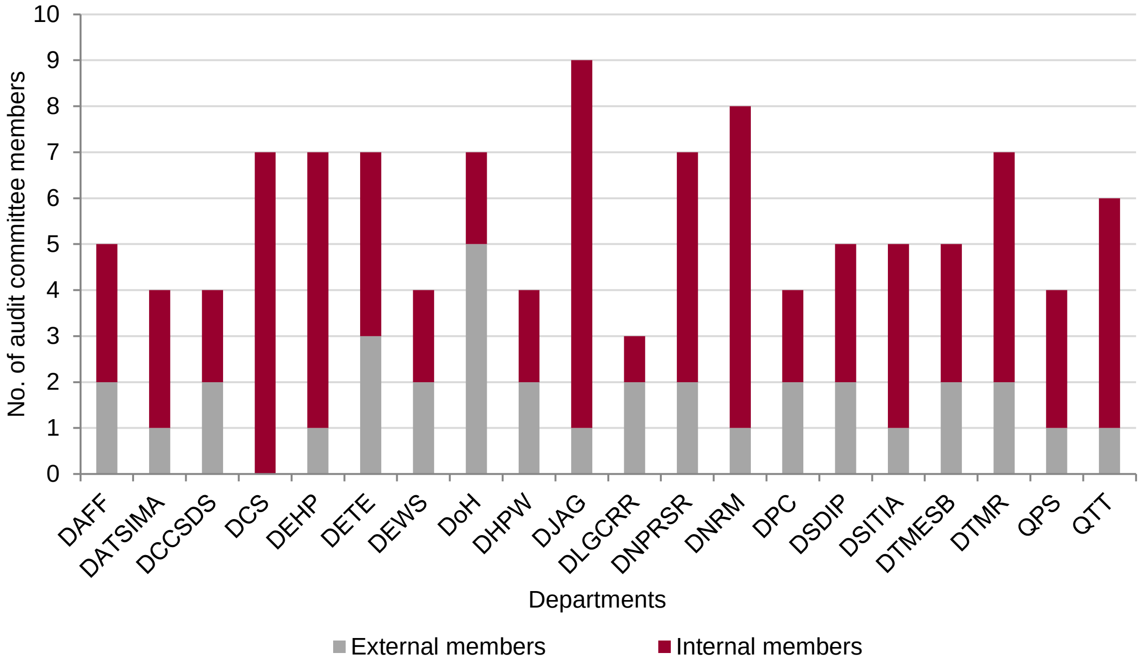
- the design and operation of internal controls
- financial statements and financial management
- risk management strategies and plans
- information systems and data security
- strategies to limit fraud and misappropriation
- compliance with legislation and key government policies.

Queensland Treasury and Trade guidelines suggest audit committees should have a minimum of three members and a maximum of six members. The guidelines also state it is desirable that two members are external to the agency to provide independent input from an 'outside' perspective. The Under Treasurer wrote to all Directors-General in February 2013, encouraging them in the long term to appoint more independent members to a department's audit committee so at least half of future membership numbers are independent.

A large audit committee comprising mainly department management representation may be seen as an extension of a department's management committee and lacking an independent perspective. Reducing the number of audit committee members and changing internal members to invited guest status would provide a better balance.

Figure 4C shows the total number of audit committee members and extent of external member representation. The average committee membership numbered around six, the maximum recommended benchmark. Eight of the 20 departments had more than this average and seven departments had only one external member. The Department of Community Safety had no external members pending the finalisation of an ongoing external review.

Figure 4C
Total number of audit committee members and extent of external membership



Source: QAO

All members had the necessary skills and experience to contribute to the committees' results.

It is highly desirable that the chair is independent of the department. The guidelines recommend that the Director-General should not undertake the role of chair of the audit committee.

Six of the 20 departments' audit committees were chaired by the department's Director-General:

- Department of Community Safety (DCS)
- Department of Environment and Heritage Protection (DEHP)
- Department of National Parks, Recreation, Sport and Racing (DNPRSR)
- Department of Natural Resources and Mines (DNRM)
- Department of Tourism, Major Events, Small Business and the Commonwealth Games (DTESB)
- Department of Health (DoH).

While DoH has its Director-General as its chair, this is offset to some extent by having five external audit committee members, including four members not from the Queensland public sector.

4.7 Key responsibilities

The key responsibilities of an audit committee include:

- reviewing management judgements included in financial statements (financial oversight)
- reviewing the effectiveness of internal controls (internal controls)
- monitoring the role and effectiveness of internal audit (internal audit)
- reviewing and monitoring the external auditor's effectiveness (external audit)
- reporting to the Director-General on how well the committee has fulfilled its responsibilities (self- assessment).

4.7.1 Financial oversight

Audit committees should consider any new or changed significant accounting policies and significant financial reporting issues and judgements made by management when annual statutory financial statements are prepared.

Audit committees provide value by resolving, or reviewing and making recommendations on the various financial reporting issues. Committees streamline the annual financial statement process by considering and resolving these issues from the start of the financial year.

All audit committees had reviewed the 2011–12 final financial statements prior to recommending management certification.

In February 2013, the Under Treasurer encouraged Directors-General to implement a number of strategies to streamline the financial statement preparation process for future years. These included preparing *pro forma* financial statements by April 2014 for the 2013–14 financial year. For an audit committee to add further value to the annual financial statement process, these *pro forma* financial statements should be available for review by audit committees prior to 30 June.

4.7.2 Internal controls

Audit committees evaluate the adequacy of the control environment and provide assurance to the Director-General that the internal control systems are of a high standard and functioning effectively. To do this, audit committees should review departments' internal control frameworks, scrutinize the findings of internal and external audit and consider whether management's responses to those findings are appropriate.

All 20 audit committees relied on the assurance statement of the chief finance officer (CFO) and internal and external audit reports to provide this assurance. As the financial accountability legislation places prominence on the CFO certification and audit committees rely on it, audit committees need to be satisfied that the process and underlying evidence is sufficient and appropriate to support the statement.

Chapter 2 of this report addresses the effectiveness of the CFO certification, where it was noted as better practice for the CFO to discuss the CFO certification design with the audit committee to provide an opportunity for early consultation and feedback.

4.7.3 Internal and external audit

Chapter 3 of this report addresses the effectiveness of the internal audit and noted the Department of Community Safety has weaknesses in its internal audit function due to long outstanding high risk internal audit issues and the absence of a formal audit work plan for 2012–13. Three other departments also had long outstanding high risk internal audit issues.

The *Financial Accountability Act 2009* requires a Director-General to approve the annual internal audit plan, based on the recommendation of the audit committee. Audit committees should have reviewed the annual internal audit plan before the start of the financial year to which it relates. The review enables the audit committee to identify and include in the plan areas where the Director-General requires additional assurance. Another key role for the audit committee is to ensure that management takes internal audit findings seriously and acts on the committee’s recommendations.

The audit committee should review the external audit plan when it is available. The external audit plan helps the audit committee to understand the areas of financial risk and controls to be tested as part of the annual statutory financial statement audit. All departmental audit committees reviewed the external audit plan.

4.7.4 Self assessment

The FPMS requires an audit committee to report each year to the Director-General on its own operations. The self assessment process can assist the audit committee meet its objectives efficiently and effectively by reviewing and analysing the work it performed.

During 2011–12, a number of departments experienced significant structural alterations as a result of machinery of government changes. This resulted in the establishment of new departments and inaugural audit committees with self assessments planned for the conclusion of 2012–13, being the first year of operation.

Self assessments for 2011–12 had not been undertaken or could not be provided as evidence of having been undertaken for the Department of Communities, Child Safety and Disability Services and the Department of Education, Training and Employment.

4.8 Proceedings

Effective audit committees depend on good planning and regular meetings. Audit committees' discussions are enhanced if agenda items are supported by briefing papers that outline matters for discussion clearly and concisely, including action required by the committee.

All 20 committees issued adequate agendas and papers with enough time for members to review their content before the meetings.

The guidelines recommend that audit committees meet at least quarterly. Meetings should also be timed to fulfil the key activities of the audit committee, including reviewing audit reports and financial statements.

All departmental audit committees met on a timely basis, four or more times in the year.

While audit committee meetings should not be excessively long, sufficient time should be reserved during the meetings so that audit committee members can speak openly and candidly on agenda matters and with invited attendees. The average duration of audit committee meetings during the year was two hours and this was considered to be adequate.

5 Corporate card control

In brief

Background

Corporate cards can improve purchasing efficiency and reduce transaction costs; however, controls must be in place to restrict unauthorised transactions and detect misuse. We audited internal controls at departments over the issue, protection and use of these cards. We also assessed whether departments were using corporate cards effectively to reduce their purchasing costs.

Conclusion

Overall, there are sound internal controls for issuing corporate cards across the 20 departments; however, control improvements are required in some departments in the areas of their acquittal, return and cancellation and the monitoring of irregular transactions.

Significant administrative savings remain available through greater use of cards by departments to purchase low value, low risk items.

Key findings

- All departments had sound control frameworks for the issue, protection and use of corporate cards. Issues relating to cancellation of cards and untimely acquittal were noted in the implementation of this framework.
- Seventeen departments reviewed reports produced by Queensland Treasury and Trade on potential fraudulent expenditure; however, none conducted an independent assessment of unusual transactions that require monitoring.
- All departments kept appropriate records and performed adequate follow up of high risk transactions tested. Appropriate remedial action was taken in three instances where card use, while legitimate departmental expenditure, was inconsistent with departmental policy.
- Ten per cent of cards had not been used at all and 15 per cent were low use, averaging $235 a year.
- Annual administration cost savings of $10.6 million could be achieved if all purchases worth less than $5 000 were paid with corporate cards instead of traditional channels.
- Departments do not monitor overall card expenditure patterns by setting benchmarks to optimise corporate card use.

5.1 Background

The *Financial Accountability Act 2009* (FAA) and the supporting Financial and Performance Management Standard 2009 (FPMS) provide a legislative basis for the control, issue and use of corporate purchasing cards. The FAA requires departments to conduct their banking with the financial institution approved by the Treasurer.

The FPMS requires that departments have a system to identify, approve, manage and record expenses and pay them in a timely manner, the details of which must be set out in their Financial Management Practice Manual.

Systems for corporate card facilities must also comply with the Treasurer's Guidelines for the use of the Queensland Government Corporate Purchasing Card which provide detailed guidance for the implementation and maintenance of corporate cards.

Under the guidelines, departments must:

- document and maintain their own agency guidelines for the use of the Queensland Government corporate purchasing card to outline the policies and processes that apply to the use of corporate cards
- issue corporate purchasing cards to only those staff members whose duties provide scope for effective use (for example, staff whose roles require the purchase of goods and/or services and who have financial delegation to do so)
- train staff on the use of the card, in line with the state procurement policy and the agency guidelines for the use of the Queensland Government corporate purchasing card
- keep a record of cards, cardholders and their supervisors—card details should be stored in accordance with payment card industry data security standards
- ensure cards are not used for cash withdrawals or cash advances and set monthly credit limits and transaction limits for each individual cardholder
- ensure that cardholders account for all transactions and reconcile them to supporting invoices each month
- ensure that cardholder supervisors review all transactions for legitimacy each month
- investigate suspected misuse and take appropriate action where either accidental or intentional misuse has occurred.

Corporate purchasing cards were introduced in 1993 as a less costly and more efficient way for Queensland Government departments to purchase low value, high volume goods and services, such as office supplies, accommodation and airfares.

Traditional purchase to pay procurement methods, where purchase orders are raised and invoices submitted, currently cost most departments $19.85 per transaction, due to the increased clerical processes involved. In comparison, the cost of each corporate card transactions is $2.50. Other benefits of corporate cards include:

- faster acquisition of goods and services
- increased transparency of transactions
- quicker payment of suppliers
- card provider rebates.

All departments, with the exception of the Department of Education, Training and Employment (DETE) and the Department of Health (DoH) use the shared service provider, Queensland Shared Services for corporate card services, which include card application, issue and maintenance of the cardholder register.

5.2 Audit objectives

Our objective was to assess the effectiveness of controls over corporate card expenditure and their use across the 20 departments. The audit examined:

- the policies and procedures for the issue and return, acquittal and monitoring of corporate cards
- the effective use of corporate cards to purchase goods and services.

5.3 Conclusions

Overall, there are sound internal controls for issuing corporate cards across the 20 departments. However, control improvements are required in some departments in the areas of their acquittal, return and cancellation and the monitoring of irregular transactions.

Significant administrative savings remain available through greater use of cards by departments to purchase low value, low risk items. If all transactions under $5 000 are paid using corporate cards, administrative savings in excess of $10 million each year can be made.

Departments were not reviewing the merits of their respective strategic procurement channels to enable more effective use of corporate cards. Departments were not monitoring trends in corporate card usage by defining benchmarks and targets. Ten per cent of cards were not used within the last 12 months, and 15 per cent were used to purchase goods worth less than $500.

5.4 Findings summary

Figure 5A details the specific findings for departments where we identified improvement opportunities.

Figure 5A
Departments with elements for improvement

Element	Department/s	Findings for 2012–13
Issue and return	DETE	Extended delays in cancelling corporate cards after employment ended
Acquittal and monitoring	DLGCRR	Extended time taken for acquittals during the year
	DCS	Monitoring reports for high risk transactions were not regularly reviewed
	DEHP, DNPRSR	Monitoring reports for high risk transactions were only regularly reviewed from February 2013 onwards
Effective use	All	Monitoring overall card expenditure patterns could be improved by defining benchmarks and targets to maximise benefits of use

Source: QAO

5.5 Policies and procedures

The *guidelines* require the following controls and procedures for the issue, protection and use of corporate cards:

- identification of appropriate and inappropriate card expenditure
- protection of the physical card and the card details, including the personal identification number (PIN)
- training and induction, including an agreement to conditions of use, before a card is issued
- timely acquittal of transactions by the cardholder and processes for disputed transactions
- timely review of transactions by the cardholder's supervisor
- disciplinary action for accidental or intentional misuse.

All 20 departments had sound policies and procedures in place.

In addition, a comprehensive corporate card provider agreement exists between the State of Queensland and the corporate card provider. It includes liability insurance that protects all departments against any unauthorised use committed by cardholders.

5.6 Issue and return

5.6.1 Issue and induction

The guidelines require departments issue corporate cards to those staff members best placed to use them; provide staff with appropriate training; keep secure records of cards and cardholders; and set limits for use.

All departments require staff members to undergo training before a corporate card is issued. Our testing indicated that corporate cards are seldom misused which indicates that training has been effective in informing cardholders of their responsibilities.

5.6.2 Transaction limits and merchant restrictions

The agreement with the corporate card provider includes a provision to establish cards with transaction and credit limits and merchant restrictions (for example, restricting vendors for which transactions would be unlikely), as instructed by the department. The agreement also provides for a whole-of-government ban on cash withdrawals.

Limits and restrictions are enforced when a vendor enters the card information into a point of sale machine, which transmits the card details to the card provider. The provider will either approve or deny the transaction, based on cardholders' available credit and the applicability of any blocks placed on the card.

All departments had set standard monthly and transaction limits as part of their corporate card policies. We confirmed that all active departmental corporate cards have transaction and monthly limits and are blocked from performing cash withdrawals.

Limits and restrictions will only be enforced for electronic payments that allow the merchant to exchange information with the card provider. In rare instances where the merchant cannot connect to the provider network or a manual credit card payment is processed, the merchant will not be aware of the limits or blocks on the card and may process unauthorised transactions.

Such instances where limits or blocks are breached are detected through monitoring reports produced by Queensland Treasury and Trade and provided to departments for follow up. In the 2012–13 financial year, there was one cash withdrawal (for an amount less than $2 000), 33 instances where transaction limits were exceeded (totaling $54 157) and 50 instances where monthly limits were exceeded (totaling $35 950). These breaches must be observed in the context of the overall corporate card program, which processes over one million transactions each year.

5.6.3 Return

Under the guidelines, cards must be returned immediately and destroyed upon cessation of employment or where the card is no longer required to mitigate the risk of expenditure being incurred by a non-government employee.

Departments were recovering cards from staff members who no longer required them; however, the Department of Education and Training and Employment did not do so in a timely manner. Three cards issued to school staff members remained active for an average of 490 days after employment ended and 26 cards issued to central and divisional staff members were cancelled, on average, 72 days after employment ended.

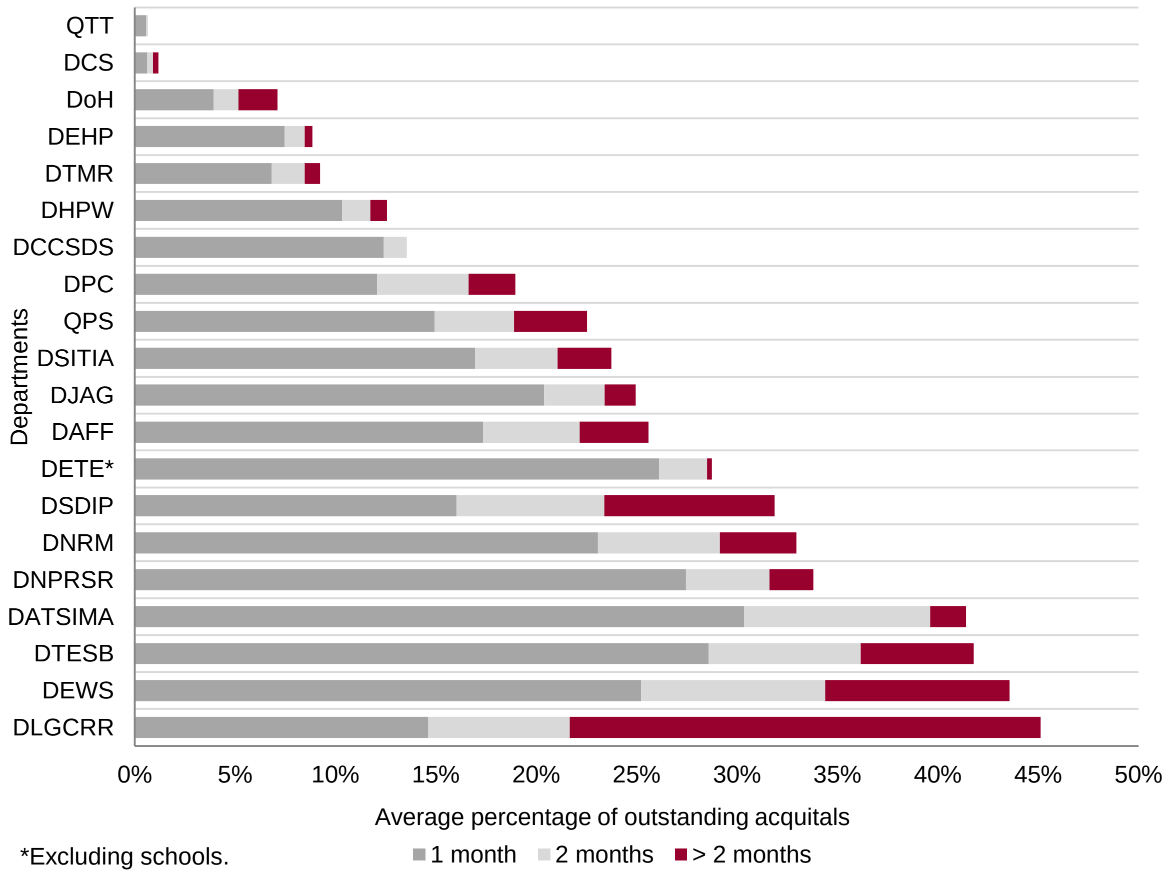
5.7 Acquittal and monitoring

5.7.1 Acquittal

The guidelines require cardholders to account for all transactions, to reconcile transactions to cardholder statements monthly and to process and store any supporting documents appropriately. The cardholder's supervisor must review all transactions for legitimacy in a timely manner each month.

Figure 5B shows the time taken to acquit the monthly corporate card statements across the departments.

Figure 5B
Average percentage of outstanding acquittals



Source: QAO from QSS, DETE and DoH supplied data for 2012–13.

On average, more than 20 per cent of acquittals were not performed monthly at 12 departments. The Department of Local Government, Community Recovery and Resilience had, on average, 23 per cent of acquittals that took longer than two months to complete.

5.7.2 Monitoring of unusual transactions

The guidelines state that:

> *…Key safeguards come from strong and effective internal controls for processing claims including, the verification of all transactions (with relevant documentation) by a person other than the cardholder, together with regular monitoring of expenditure patterns…*

Reports on high risk transactions and potential frauds are produced by the Queensland Treasury and Trade (QTT) Government Banking Unit and forwarded to all departments on a monthly basis.

The reports cover transactions such as:

- purchases from merchants that sell items not approved for purchase such as tobacco
- international transactions
- transactions and cards that have exceeded the transaction and monthly limits
- possible transaction splitting to avoid card limits
- card use on weekends and public holidays
- new, cancelled or reissued cards.

The Department of Community Safety did not review these reports regularly for fraudulent activity. The departments of Environment and Heritage Protection and National Parks, Recreation, Sport and Racing, only reviewed their reports from February 2013 onwards.

The QTT report was developed based on *internal knowledge* and *feedback from departments*. *It* uses the merchant category code, assigned to each merchant by his or her card provider to describe the merchant's primary business, to identify potentially fraudulent transactions. The report covers the majority of merchant codes that we would classify as high risk, including codes for alcohol, betting, personal services and cash withdrawals. It should be noted that the merchant category code assigned may represent all items supplied by a merchant; for instance, many suppliers identified as bars also provide accommodation. As a result, all potential misuse must be investigated on a case by case basis.

Whilst the QTT report *provides a good basis for identifying potential misuse, there was no evidence that departments had performed an analysis of the types of expenditure that are unusual for* their individual business, *nor developed reports for any gaps identified. A department that uses iPhones and iPads may have legitimate expenditure through the iTunes store and may not require exception reports relating to this merchant; however, for departments that do not have such products, it may indicate misuse.*

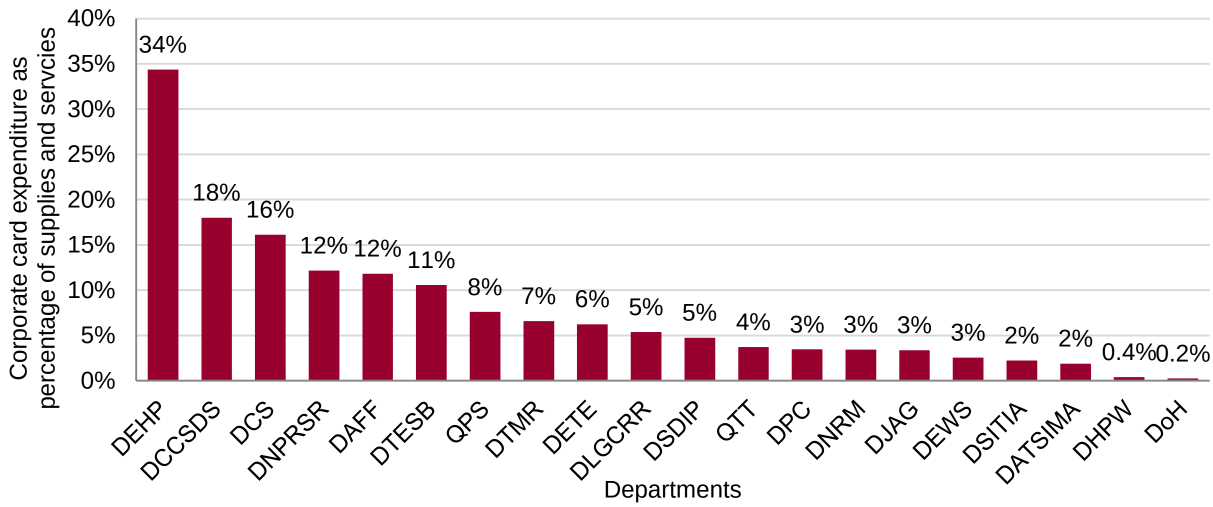
We tested 49 high risk transactions. Departments had kept appropriate records and performed adequate follow up, where required, in all instances. Three of the transactions identified related to legitimate items of expenditure; however, the way in which the card was used had contravened departmental policy. In one instance a card was used to purchase foreign money for a teacher travelling on an international school trip. Such a purchase is equivalent to a cash withdrawal, and is prohibited by the Treasurer's guidelines. In these instances, appropriate remedial action was taken. This indicates that the detective controls designed are operating in practice.

5.8 Effective use

5.8.1 Current use

The 20 departments were estimated to spend approximately $8.3 billion on goods and services for 2012–13. Over $370 million (4.5 per cent of total goods and services) of state government purchases were made through corporate purchasing cards in 2012–13. On average, corporate card expenditure equals 7.7 per cent of departmental expenditure on supplies and services, as shown in Figure 5C.

Figure 5C
Corporate card expenditure as a percentage of estimated supplies and services 2012–13

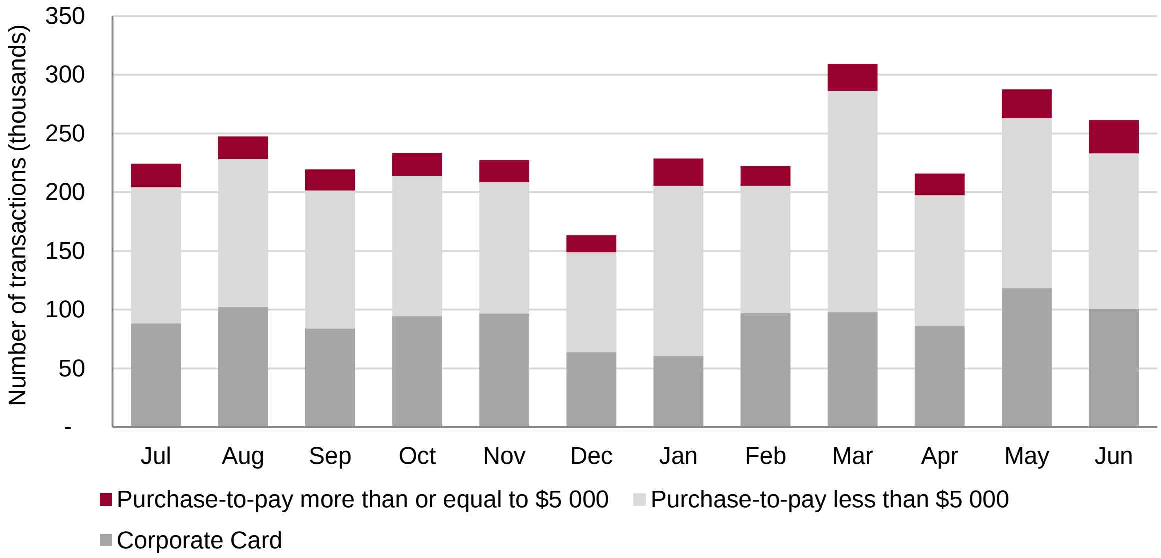


Source: QAO from bank supplied data and 2013–14 service delivery statements

There is scope for all departments to make greater use of corporate cards as part of their overall purchasing strategies. On average, 20 percent of departmental expenditure through purchase to pay related to low value purchases under $5 000, as shown in Figure 5D.

As the QTT's non-current asset policies for the Queensland public sector stipulate that the capitalisation threshold is $5 000, lesser amounts would normally represent recurrent expenditure that could be paid by corporate card.

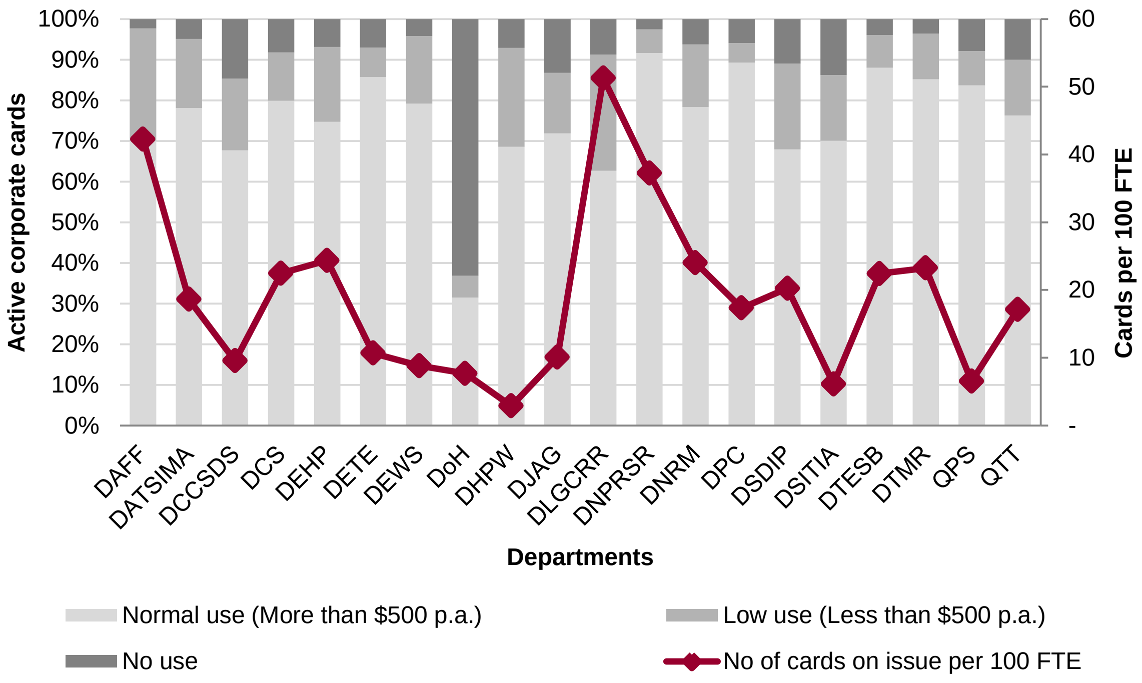
Figure 5D
Total purchase transactions by purchasing method for 2012–13 for all departments



Source: QAO from QSS supplied data and DETE and DoH financial system extracts

On average, 90 per cent of cards on issue were used to make purchases during 2012–13, meaning that 10 per cent were not used at all. Fifteen per cent of the cards that were used had a total spend of less than $500 for the year, as shown in Figure 5E.

Figure 5E
Level of use of active corporate cards by department 2012–13



Source: QAO from corporate card provider supplied data

Whilst DoH's card usage was significantly lower than other departments, the number of cards issued to staff was low, with only eight cards issued for every 100 full time equivalent (FTE) staff members. The average number of cards issued across all departments was 19 per 100 FTE.

5.8.2 Monitoring effective use

Expenditure patterns need to be reviewed for individual cardholders and on a departmental basis.

QTT generates reports on corporate card expenditure for discussion at the meetings of all departmental chief finance officers. The reporting does not include information on expenditure through the traditional purchase to pay process, so there is no overall view on any shift between purchasing channels.

These reports are not distributed to departments and our testing has shown that 13 departments are not monitoring overall card expenditure patterns. These departments did not have the relevant information to determine if cards were being used effectively or if cards were issued to staff members best placed to use them for departmental benefit (i.e. staff in purchasing roles, with appropriate financial delegation).

The seven departments that were monitoring overall corporate card expenditure were:

- Department of Agriculture, Fisheries and Forestry (DAFF)
- Department of Education, Training and Employment (DETE)
- Department of Justice and Attorney-General (DJAG)
- Department of Local Government, Community Recovery and Resilience (DLGCRR)
- Department of Natural Resources and Mines (DNRM)
- Department of Tourism, Major Events, Small Business and the Commonwealth Games (DTESB)
- Queensland Treasury and Trade (QTT).

None of the departments had defined benchmarks or targets to optimise the use of corporate cards and no clear actions had been taken as a result of monitoring.

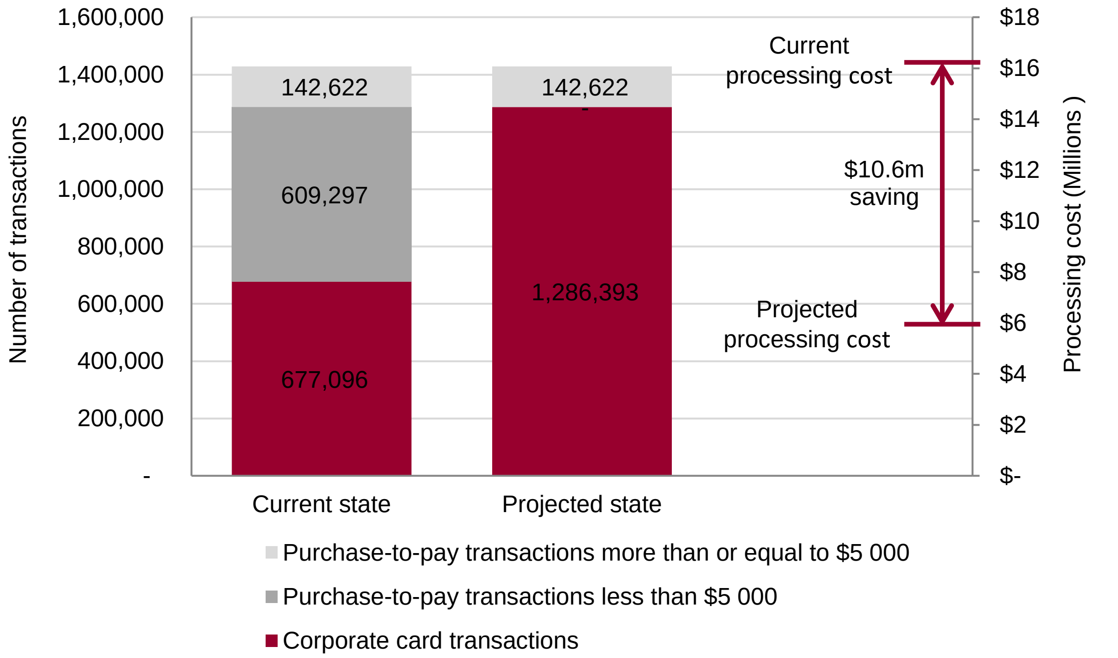
5.8.3 Benefits of increased use

The benefits of increased use of corporate cards include reduced administration time spent processing the transactions and reduced cost per transaction when compared with the purchase to pay method.

QTT's review of corporate cards in 2007 found that departments saved an average of 41 minutes per transaction by using corporate card as opposed to purchase to pay. A 2012 survey of US organisations also found that corporate cards reduced the procurement cycle time by approximately nine days. Increased use of corporate cards could drive efficiency savings, both for departments and shared service providers, through reduced processing times.

Current processing fees charged by QSS for shared services departments are significantly higher for purchase to pay ($19.85) than corporate card transactions ($2.50). Low value expenditure (less than $5 000) represented 81 per cent of transactions processed by purchase to pay in 2012–13—expenditure suitable for purchase via corporate card. If these purchases were made by corporate card, $10.6 million per annum in processing costs could be saved, as shown in Figure 5F.

Figure 5F
Current and projected processing costs and channel mix for shared service departments

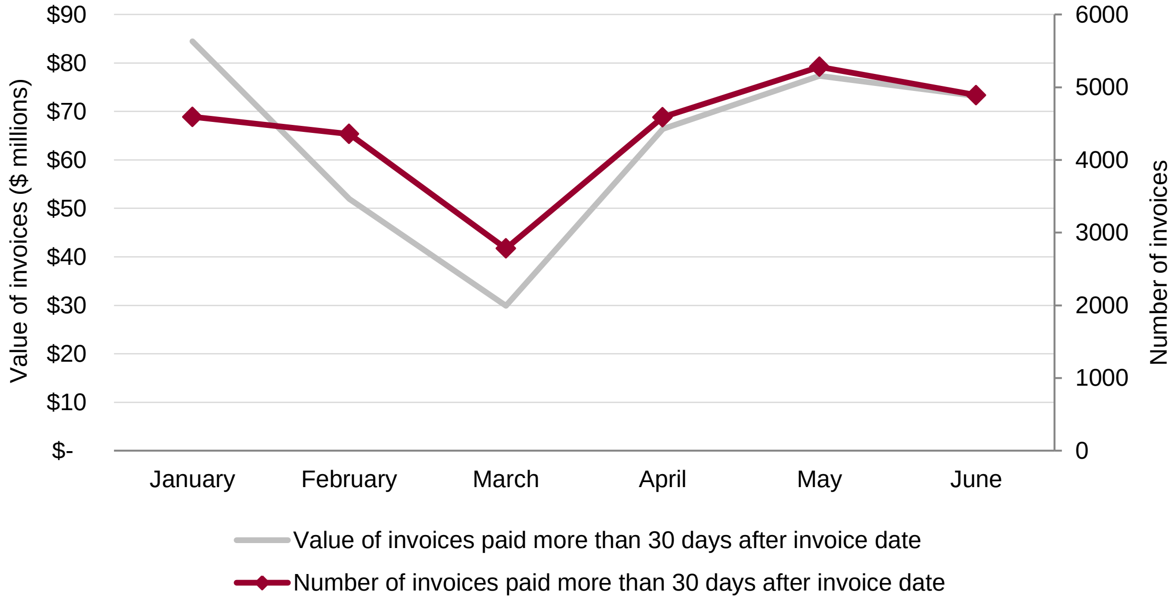


Source: QAO from corporate card provider and QSS supplied data for 2012–13

In addition, the card provider pays the Queensland Government a tiered rebate equal to approximately 0.6 per cent of total expenditure under the current card arrangement. The rebate for the 2012–13 financial year was around $2.3 million.

Corporate cards also benefit suppliers as payments are processed immediately at the time of purchase. In comparison, each month an average of 11 per cent of invoices, equating to approximately $63.9 million, are paid more than 30 days after the invoice date as shown in Figure 5G.

Figure 5G
Invoices less than $1 million paid more than 30 days after the invoice date for January to June 2013



Source: QAO from QSS supplied data

Appendices

Appendix A—Comments 59

Appendix A—Comments

Auditor-General Act 2009 (Section 64)—Comments received

Introduction

In accordance with section 64 of the *Auditor-General Act 2009* a copy of this report was provided to the following departments with a request for comment:

- Department of Aboriginal and Torres Strait Islander and Multicultural Affairs
- Department of Agriculture, Fisheries and Forestry
- Department of Communities, Child Safety and Disability Services
- Department of Education, Training and Employment
- Department of Energy and Water Supply
- Department of Environment and Heritage Protection
- Department of Health
- Department of Housing and Public Works
- Department of Justice and Attorney-General
- Department of Local Government, Community Recovery and Resilience
- Department of National Parks, Recreation, Sport and Racing
- Department of Natural Resources and Mines
- Department of Police and Community Safety
- Department of the Premier and Cabinet
- Department of Science, Information Technology, Innovation and the Arts
- Department of State Development, Infrastructure and Planning
- Department of Tourism, Major Events, Small Business and the Commonwealth Games
- Department of Transport and Main Roads
- Queensland Treasury and Trade.

A fair summary of the responses received are included in this Appendix.

Responsibility for the accuracy, fairness and balance of the comments rests with the head of these agencies.

Comments received

Response provided by the Director-General, Department of Agriculture, Fisheries and Forestry on 8 November 2013:

…The department has reviewed the overall findings of the draft report to Parliament and that contained in the 2012–2013 Final Audit Report for the Department of Agriculture, Fisheries and Forestry, and is undertaking the following business improvement initiatives as a result:

Chief Finance Officers Certification — establishing a detailed risk register for financial statements and developing additional processes and tools to augment the continuous assessment of financial risk and internal controls throughout the financial year

Audit and Risk Committee — evaluating the quality of the internal audit function, particularly in areas of planning, monitoring, reporting and

Corporate Card Controls and Use—putting in place processes to optimise the use of corporate cards across the department…

Response provided by the Director-General, Department of Aboriginal and Torres Strait Islander and Multicultural Affairs by email on 14 November 2013:

…I note the findings you have made for my department and the department will implement any relevant actions as soon as possible, including improving the department's utilisation and monitoring of corporate cards.

I would like to respond in particular to the finding in relation to the level of DATSIMA's internal audit resourcing compared to benchmarks.

DATSIMA's internal audit function is provided by the Department of Communities, Child Safety and Disability Services (DCCSDS) under a memorandum of understanding at a cost of $0.145M per annum. While the budget for internal audit services may seem low when compared to the department's overall budget, DATSIMA leverages off the partnership arrangement with DCCSDS to obtain a significant amount of additional support due the number of systems DATSIMA shares with DCCSDS. Under the annual audit plan, four business assurance (compliance) audits and one operational audit are conducted each year on discrete departmental business units or functions, and separate testing is conducted on the annual financial statements. In addition, given the finance systems are shared with DCCSDS, a further four annual data analytic audits are conducted on components of the department's financial functions in conjunction with DCCSDS.

DATSIMA's Audit and Risk Committee (including external representation) is satisfied that the range and scope of audits conducted provide comprehensive assurance of the department's internal controls…

Response provided by the Director-General of the Department of Communities, Child Safety and Disability Services on 6 November 2013:

…I note the findings you have made for the Department of Communities, Child safety and Disability Services and Head of Internal Audit will implement any relevant actions as soon as possible, including an external assessment of the internal audit function, updating the Internal Audit Charter and conducting an Audit Committee self-assessment. A number of actions have also been put in place by the Chief Finance Officer to improve the department's utilisation and monitoring of corporate cards.

Please find … the relevant issues highlighted in your report and the department's detailed response to those issues.

Internal audit charter does not include some components that are considered important in the report:

- *Charter recently updated in line with the Financial Accountability Handbook and the Australian National Audit Office Best Practice Guidelines and presented to September 2013 meeting of the Audit Committee.*
- *Audit Committee delayed endorsement pending outcome of Report to Parliament.*
- *Final Charter to be approved by end of 2013*

External assessment of internal audit not conducted since 2007

- *Due to the changes to the department and the internal audit function over the past 18 months, an external assessment was not able to be conducted*
- *internal audit has a quality assurance and improvement program in place which includes internal performance assessments*
- *2013–14 Annual Audit Plan includes an independent external assessment scheduled for early 2014.*

Outstanding high risk audit recommendations

- *Majority of these recommendations are related to information technology and have now been closed.*
- *One recommendation still outstanding relating to community recovery payments, which will be implemented upon introduction of a new information system due before the end of 2013.*

Audit Committee self-assessment not undertaken

- *Assessment not undertaken at the end of the 2011–2012 financial year due to the machinery of government changes.*
- *A self-assessment will be conducted early in 2014 upon commencement of the new Audit Committee.*

Corporate Card utilisation and monitoring

- *The department is seeking to increase utilisation and distribution of corporate cards as an efficient method of procurement.*
- *The Chief Finance Officer has updated policies and procedures, improved training and disseminated information to cost centre managers and business services managers on the cost and other benefits of using corporate cards for low value procurement*
- *Monthly reviews of corporate card expenditure are conducted at the whole of department and individual cardholder level as well as reviewing the monthly Queensland Treasury and Trade exceptions report…*

Response provided by the Minister for Education, Training and Employment on 12 November 2013:

…The Department of Education, Training and Employment (DETE) wishes to provide comment on the proposed report.

Firstly, the section of the report on Internal Audit notes that DETE had in February 2013 a high number of outstanding high risk audit recommendations which had not at that time been implemented. As advised in my letter dated 16 October 2013, my Department has made a concerted and successful effort to reduce these issues. The number of recommendations outstanding in November 2012 was 34, reducing to 20 in March 2013, and five matters in August 2013.

Secondly, in relation to the Finance comments on the section of the report on corporate card control — that the responsibility for the cancellation of a corporate card rests with the business unit that holds that card, or the relevant corporate card holder/line manager. This requirement is outlined in my Department's Conditions of Use Form that both the cardholder and line manager sign prior to being provided with a departmental corporate card.

Given the large card base of DETE, to address this issue of cards not being cancelled in a timely manner a systemised solution was required. In March 2013, the DETE Corporate Card Unit (CCU) commenced a new process of reviewing the Terminated Employees report from both of my Department's payroll systems (TSS and Aurion) to identify any officers leaving my Department. These reports are checked against the corporate card register to determine if any of the departing officers hadn't arranged for their respective corporate card to be cancelled. This report is actioned on a monthly basis.

In addition, two further activities were completed recently to reinforce the correct procedures for the use of a corporate card. In September 2013, an email advice was forwarded to all cardholders and their line managers reminding them of their requirement to cancel cards promptly if they are no longer required. Secondly, a bulletin advice was included in the departmental Schools Update in October 2013 which is sent to all state schools, again reminding school personnel of their requirement to cancel cards promptly if they are no longer required.

The implementation of my Department's new SAP ERP6 Finance system in October 2013 included the introduction of a new document type for recording corporate card transactions. This will enhance the reporting capability on corporate card expenditure…

Response provided by the Director-General of the Department of Justice and Attorney-General on 12 November 2013:

…I note a number of areas where you have assessed deficiencies in DJAG's audit function and the Audit and Risk Management Committee (the Committee), However, I do not believe the report and the conclusions reached, afford consideration of systems and measures implemented to provide assurances around DJAG's governance framework.

You have raised questions around the effectiveness of the audit function and Committee due to a high number of outstanding high risk internal audit issues. As discussed recently with representatives of the Queensland Audit Office (QAO), a number of measures are in place to ensure such matters are actively considered by management.

All officers responsible for the implementation of audit recommendations are provided with access to an audit tracking system to allow reporting of progress against agreed timeframes. The system issues monthly email reminders to the actioning officer detailing those issues outstanding, but not yet overdue. In addition, fortnightly email reminders are issued to the actioning officer and supervisor for those matters considered overdue.

When matters become overdue, clients are required to lodge a business case with the Chair of the Committee requesting an extension of the original due date. This business case must be endorsed by a Manager/Director prior to tabling with the Chair. The Chair may then approve or decline the extension.

Further, as a standing agenda item, the Committee consider those matters classified as long outstanding. Each quarter, the Committee is provided with a detailed analysis of the matters outstanding. Having regard to the structure of the Committee, a divisional representative is available to provide further information if required, on the status of this issue. The Committee, including representatives from the QAO is encouraged to consider and discuss these issues at this forum.

Further, in a recent initiative implemented by Internal Audit, executive management is also issued with a listing of outstanding matters for their review, follow-up and action.

Delays in the actioning of audit recommendations may arise due to a myriad of issues. However, I contend that the measures adopted by Internal Audit and the Committee are appropriate and should not reflect poorly on the audit function or Committee.

It is also worth noting that whilst the QAO has been critical of the Internal Audit function in implementing high risk audit issues within the recommended timeframes, similar delays were also noted in issues raised by the QAO. As reported in the May 2013 Audit and Risk Management Committee meeting, 37 issues were considered outstanding, inclusive of 12 matters raised by the QAO.

In documentation provided to representatives of the QAO on 21 October 2013, outstanding issues had decreased to 19 high risk issues. However, of this total, 11 issues (i.e. 58%) related to high risk outstanding matters raised by the QAO. I note your Report does not recognise these statistics relevant to follow-up by the QAO.

Your Report also references improvements required to the Committee structure due to an excessive number of members. Following a recent review of Governance Committees following the transition of Queensland Corrective Services to my Department, I have approved an amended Audit and Risk Management Committee structure, comprising eight members. I acknowledge this is contrary to the guidelines which suggest audit committees should have a maximum of six members.

However, having regard to the complex and diverse nature of DJAG, I consider that collectively, the Committee has a thorough understanding of the core activities relevant to DJAG. Accordingly, I am satisfied that the appropriate mix of skills and experience are present within the Committee to effectively discharge its obligations under its Terms of Reference.

Finally, I express concern in the approach adopted by the QAO in respect of this audit. I am informed that a desktop based approach was used for the conduct of this audit and accordingly, key parties were not consulted throughout the audit phase. Information was not validated or sought from key parties prior to the QAO formulating conclusions and assessments on the audit function. This resulted in unnecessary interactions with management during the reporting phase. The unavailability of representatives of the QAO, directly involved in the audit process also proved problematic when seeking to clarify the origin of opinions expressed in your Report. I encourage the QAO to directly liaise with identified parties in the first instance for future audit engagements…

Response provided by the Director-General of the Department of Local Government, Community Recovery and Resilience on 4 November 2013:

…I have reviewed the report and concur with the content and recommendations. Where applicable, the Department has responded to local issues and is committed to the improvement of internal controls. The results and recommendations outlined in the report will be reviewed and applied where appropriate…

Response provided by the Director-General, Department of National Parks, Recreation, Sport and Racing on 8 November 2013:

…I appreciate the opportunity to respond to those areas of the report to Parliament relevant to the Department of National Parks, Recreation, Sport and Racing (NPRSR). Please find below comments for consideration, which have been placed under their respective chapters for ease of reference.

Chapter 2 — Chief Finance Office Certification

NPRSR has not been specifically identified in the findings summary as having elements assessed that require improvement.

In response to the general finding for all departments recommending the implementation of a specific register focusing on financial reporting risks, NPRSR considers that a further risk register is not required in addition to the current strategic and operational risk registers. However, NPRSR is in the early stages of mapping key risks to the financial ledger and will then assess the controls that exist to mitigate these risks.

Chapter 3 — Internal Audit

In your original report, NPRSR was identified as having a significant delay in the approval of the internal audit work plan. As reported, NPRSR's internal audit services were initially provided by the Queensland Government Internal Audit Service across six departments. This arrangement was not efficient or effective for NPRSR with little audit work being completed by 31 December 2012 (that is, eight months after NPRSR was enacted and six months after the Business and Corporate Partnership across the six departments begun operation).

In accordance with the partnership arrangements, I negotiated to withdraw in-house resources to establish a stand-alone internal audit function for NPRSR. This arrangement was signed off on 18 February 2013 with the Head of Internal Audit being nominated by 22 February 2013.

The Audit and Risk Committee members endorsed the Internal Audit Annual Plan (the Plan) at their meeting of 27 February 2013. The Internal Audit function has actioned the Plan accordingly.

I note you have withdrawn the findings in relation to "No review... undertaken as required by the Treasurer of the effectiveness of the Queensland Government Internal Audit Service (QGIAS) [sic] as of September [sic] 2013" and "little audit work being conducted....by QGIAS". In fact, a formal review of the shared Head of Internal Audit arrangement to assess whether it was operating efficiently, effectively and economically was required to be reported to the Honourable Tim Nicholls MP, Treasurer and Minister of Trade by 31 March 2013. This had not occurred at the time and I anticipated the findings.

Further, you report that "Departments are moving away from in-house audit teams towards co-sourced and outsourced models". This is not the case in NPRSR.

The report has benchmarked internal audit resourcing across the departments and NPRSR has been identified as on the margin of being potentially under resourced. As shown in your report, there was a 34% decrease in the internal audit budget across the six departments formed primarily from the previous departments of environment and resource management and employment, economic development and innovation. Similar savings were made across corporate services and attributed to the Department of Environment and Heritage Protection (EHP) as part of its fiscal repair process. I received less than one sixth of that reduced internal audit budget. It is my intention to supplement that budget based on the risk-based internal audit planning process as required.

Chapter 4 — Audit Committees

A finding was raised in relation to me being the Chair of the Audit and Risk Committee. As you report, the Director-General of each department is responsible for establishing and effectively maintaining adequate financial control. In the inaugural year of operation, rather than have the Audit and Risk Committee report its activities to me, it was my deliberate decision to Chair the Committee while the internal control framework was being established for NPRSR.

I have appointed two external members, one of whom has acted as the Chair when I have been unable to be present. The Audit and Risk Committee membership will be reviewed as part of responses to its annual self-assessment recently completed.

Chapter 5 — Corporate Card Control

The findings summary in the report identified that NPRSR had not reviewed monitoring reports for high-risk transactions.

NPRSR's corporate card service delivery is administered on its behalf by EHP. EHP was significantly impacted by the 2012 Machinery of Government (MoG) changes. As a result, EHP has been heavily focussed on agencies impacted by MoG changes with restructuring their individual corporate card accounts, reissuing new cards, cancelling superseded cards and revising and releasing new corporate card policy frameworks.It was during this period that only limited checking of the Queensland Treasury and Trade (QTT) unusual transactions reports was able to occur. However, since February 2013, comprehensive checking of all of the components of the QTT unusual transactions report has occurred each month.

In respect to the overall finding that the monitoring of overall card expenditure patterns could be improved by defining benchmarks and targets to maximise benefits of use, NPRSR already compares favourably across the sector in card uptake and usage. NPRSR intends to further encourage the usage of corporate card, particularly for low value purchases. It is investigating the best way to monitor this usage by transaction value on an ongoing basis. Further, your report does not make any mention of the fact that a number of vendors either do not accept credit card as a payment method or levy a prohibitive surcharge...

Response provided by the Director-General of the Department of the Premier and Cabinet on 13 November 2013:

…The Department of the Premier and Cabinet (DPC) supports the direction of the report, noting that, while the number of control weaknesses has declined across government, there is still room for improvement in departmental control structures.

In relation to the key finding regarding the effective use of corporate purchasing cards, I advise the following:

DPC provides guidelines to officers on the preferred payment methods for the different types and quantum of expenditure. Currently ail expenditure under $2000 is to be paid by corporate purchasing card, as opposed to direct invoice, with this process monitored by Financial Services on a daily basis. This ensures that the most cost effective payment method is chosen in every situation. However, DPC experiences some barriers to the use of corporate purchasing card, most commonly that suppliers do not accept the card as a form of payment. Over 95 per cent of low value (less than $2000) invoices paid by direct invoice are paid via that method because the supplier does not have facilities to accept the corporate purchasing card as payment. This limitation greatly restricts DPC's capacity to achieve the savings that you have outlined in your report.

In addition to this, DPC, together with Queensland Shared Services (QSS), has commenced the roll out of the SAP ECC eForm functionality. The eForm functionality will replace the paper based accounts payable process and automate the payment of supplier invoices. Indicative pricing provided by QSS is that the processing fee for direct invoices will drop to $9.40 per invoice, as opposed to the current pricing of $18.80. It is anticipated that this price may drop even further as the functionality is rolled out to more agencies. This automated process will result in significant savings for many departments…

Response provided by the Director-General of the Department of Tourism, Major Events, Small Business and the Commonwealth Games on 7 November 2013:

…The most significant finding for my agency is on Page 42 of the report under 4.4 Findings Summary, where it indicates that for the Department of Tourism, Major Events, Small Business and

the Commonwealth Games (DTESB), the fact that the Director-General is Chair of the Audit Committee is an 'element for improvement'.

I would like to provide some comments in relation to this finding.

As Director-General of DTESB, I do chair the Audit and Risk Committee, which consists of several of my senior executives and has independent external representation. It is my view that for an agency of the size and scale of DTESB, this arrangement is appropriate and the most efficient way of operating the audit committee.

DTESB is a relatively small department consisting of approximately 110 FTEs, is wholly located in standard office accommodation in the Brisbane CBD, and is wholly funded by Government through normal Treasury budgetary processes. Furthermore, the department does not have any corporate services. Corporate Services are provided through a Business and Corporate Partnership arrangement with five other agencies and are primarily housed in the Department of Agriculture, Forestry and Fisheries — hence DTESB does not operate any of its own transactional functions.

For these reasons, DTESB has a relatively low and uncomplicated risk profile.

In the case of an agency such as this, I am of the view that the most effective and efficient governance arrangement is to incorporate the required committees (eg. Workplace Health and Safety, Information Steering Committee, Audit and Risk Committee) as regular, dedicated sub-components of the Executive Management Group of which I am the Chair. Each of these sub-components has their own agenda, minutes. and secretariat as appropriate.

Having separate committees, with different membership and chairmanship, would be an inefficient use of my executives' time and would dilute the department-specific focus and knowledge available, ultimately making the committees less effective…

Response provided by the Deputy Under Treasurer, Queensland Treasury and Trade by email on 15 November 2013:

…The report makes reference to Queensland Treasury in the context of the dual responsibilities currently assigned to the Chief Finance Officer (CFO).

The report emphasises that responsibilities of both the CFO and Head of Internal Audit (HIA), as prescribed in sections 77 and 78 of the Financial Accountability Act 2009 (the FA Act), need to be given an appropriate level of attention by the nominated officers. It also stresses that apart from their perceived and actual independence, it is not clear that one officer has the capacity to effectively discharge the delegated responsibility of both operations.

In 2012–13 the internal audit function of Treasury was outsourced to PriceWaterhouse Coopers (PWC). The CFO was nominated as the HIA. The appointment had due regard to the requirements for the appointee to be a public service employee, or other employee of the State, with professional membership of specific accountancy or internal audit bodies. The CFO was in the best position to ensure the operation of the function at an appropriate level within the department.

In giving effect to the appointment, Treasury was cognisant of concerns regarding the independence of the functions. In particular, the Financial Accountability Handbook prescribes that where the same officer does undertake both roles, to maintain an appropriate level of independence, the following should occur:

- *reports from the outsourced internal audit function should be submitted*
- *direct to the accountable officer and the internal audit provider should be given the opportunity to communicate directly with the accountable officer without the HIA in attendance; and*
- *at least one meeting per year should be held between the internal audit function and the audit committee.*

Both of these conditions have been met by Treasury and are documented in the Internal Audit Charter and the Audit and Risk Management Committee Charter. While I acknowledge your view that this may not be an appropriate model for Treasury, I am satisfied that in practical terms the independence has been provided for and the risks mitigated.

In this regard, the Government has a strong focus on ensuring value for money is obtained on all public sector expenditure. This has meant that a number of departments have moved to outsourced or co-sourced internal audit arrangements. Treasury has derived significant value from the expertise that PWC has been able to bring to the function.

Going forward, Treasury may suggest to Government that the FA Act be amended to allow an accountable officer to nominate a non-public service employee to the role of HIA, thus allowing the partner (or lead auditor) of the outsourced provider to assume the responsibilities outlined in the FA Act. The minimum qualifications would remain applicable to the person nominated to the HIA role. Your views on this would be appreciated…

Auditor-General Reports to Parliament

Tabled in 2013–14

Report number	Title of report	Date tabled in Legislative Assembly
1	Right of private practice in Queensland public hospitals	July 2013
2	Supply of specialist subject teachers in secondary schools	October 2013
3	Follow up—Acquisition and public access to the Museum, Art Gallery and Library collections	October 2013
4	Follow up—Management of offenders subject to supervision in the community	October 2013
5	Traffic management systems	November 2013
6	Results of audit: Internal control systems	November 2013

Reports to Parliament are available at www.qao.qld.gov.au.