

Auditing for the Australian Capital Territory

The Auditor-General is head of the Auditor-General's Office. He and his Office act independently of the Government. The Office assists the Auditor-General to carry out his duties, which are set out in the Auditor-General Act 1996, by undertaking audits of management performance and the financial statements of public sector bodies. The aim is to improve public sector management and accountability by firstly, ensuring the Legislative Assembly and the electorate are provided with accurate and useful information about the management of public sector resources and secondly, by providing independent advice and recommendations for improving the management of public resources.



AUDITOR-GENERAL
AUSTRALIAN CAPITAL TERRITORY



PA 01/05

25 June 2002

The Speaker
ACT Legislative Assembly
South Building
London Circuit
CANBERRA ACT 2601

Dear Mr Speaker

In accordance with *Section 17* of the *Auditor-General Act 1996*, I transmit to the Speaker my Report titled "*Frameworks for Internal Auditing in Territory Agencies*" for presentation to the Legislative Assembly by the Speaker.

This Audit was managed by Greg Martin and conducted by Adrian Dalanon, Serife Ibrahim, Joseph Bartone and Mark Scanes of this Office.

Yours sincerely

John A Parkinson

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SECTION A

REPORT SUMMARY AND GENERAL INFORMATION

1. SUMMARY AND AUDIT OPINION

INTRODUCTION

1.1 This Report presents the results of an Audit of the framework for internal auditing within Territory agencies.

1.2 For the purposes of the Audit internal auditing frameworks were taken to be the established structures, systems and standards operating in agencies to assist the effectiveness of internal auditing.

1.3 Internal auditing is an independent appraisal function established within an organisation to examine and evaluate its activities. Internal auditing is defined by The Institute of Internal Auditors Australia as follows:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an agency's operations. It helps an agency accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance processes.¹

1.4 Internal auditing generally includes examining whether financial and operating information used within agencies is accurate and reliable, risks to agencies are identified and minimised, external regulations and internal policies and procedures are followed, resources are used efficiently and whether agencies' objectives are being achieved. An effective internal auditing framework supports the internal auditing function.

1.5 Sound frameworks for internal auditing incorporate audit committees and formal documented charters describing the roles, responsibilities and objectives of both the internal audit function and audit committees.

1.6 In this Report the term 'governance processes' refers to the internal controls and systems, which are used to ensure that an agency is performing efficiently and effectively as well as conforming with legislation and guidelines. Internal auditing can provide important assurance that these processes are working properly.

¹ The Institute of Internal Auditors, Standards for the Professional Practice of Internal Auditing, 2002.

AUDIT SCOPE AND APPROACH

1.7 The agencies selected to be included in the audit were chosen because of their large expenditure, turnover and/or investments.

1.8 Frameworks for the internal audit functions of the Department of Urban Services, Chief Minister's Department, Treasury, Department of Education and Community Services, Department of Health and Community Care, Department of Justice and Community Safety and the Canberra Institute of Technology were assessed.

1.9 The frameworks were also assessed for the internal audit functions of ACT Health and Community Care Service (comprising The Canberra Hospital and ACT Community Care), Kingston Foreshore Development Authority, the Public Trustee, ActewAGL, Totalcare Ltd and ACTTAB Ltd.

1.10 The Audit circulated two questionnaires. One questionnaire sought chief executives' perceptions of their agency's internal audit functions. The second questionnaire sought information on the framework in which the internal audit functions operated.

1.11 Existing internal audit charters, audit committee charters, audit plans, agency assessments of risk and procedures for the implementation of actions to address audit findings were also reviewed.

1.12 Internal auditing frameworks were assessed as adequate if they were consistent with the better practices outlined in *Chapter 2* of this Report.

1.13 The scope of this Audit was confined to the framework for agencies' internal audit functions. The conduct of the Audit and the content of this Report should therefore not be taken as providing a complete assurance that no inefficiencies or ineffectiveness exist in the performance of internal audits.

1.14 The Audit's results for each agency are presented in individual chapters within Sections B, C and D of this Report.

AUDIT OBJECTIVE

1.15 The audit objective was to provide an independent opinion to the Legislative Assembly on whether:

- the frameworks for internal auditing in Territory agencies are adequate to effectively contribute to good governance.

AUDIT OPINION

1.16 The independent opinion drawn on the audit objective is set out in the shaded box on *page 5*.

BASES OF AUDIT OPINION

1.17 While the Audit identified some examples of sound frameworks the majority of agencies' internal audit frameworks did not incorporate important better practices. As the majority of internal audit frameworks did not include various significant better practices the Audit formed the opinion that, in an overall sense, the internal auditing framework in Territory agencies was inadequate.

1.18 The following assessments of individual agencies internal audit frameworks are of the frameworks as they existed in the early stages of the Audit. Since then most agencies have either implemented improvements or have improvements planned.

Results of Individual Agency Assessments

Sound Framework

1.19 The ActewAGL internal audit framework included many better practices. ActewAGL's internal audit framework was sound (see *Chapter 15*).

Sound Frameworks Lacking Some Important Practices

1.20 The following agencies' internal audit frameworks included some significant better practices. In each, however, important better practices were absent:

- Chief Minister's Department and Department of Treasury (see *Chapter 4*);
- Department of Urban Services (see *Chapter 5*); and
- ACT Health and Community Care Service (which includes the Canberra Hospital and ACT Community Care) (see *Chapter 11*).

1.21 In responses to the Audit these agencies advised of proposals to introduce additional better practices.

AUDIT OPINION

- *The frameworks for internal auditing in Territory agencies was inadequate to effectively contribute to good governance.*

During the Audit's conduct, and in response to drafts of the Audit Report, agencies identified for implementation an array of better practices which had been absent at the commencement of the Audit. By the time the Audit was completed several of these better practices had been implemented. When the identified practices are fully implemented the frameworks for internal auditing in Territory agencies will have been significantly improved.

Reasonable Frameworks Lacking Several Important Practices

- Department of Education and Community Services (see *Chapter 6*);
- Totalcare (see *Chapter 16*); and
- Canberra Institute of Technology (see *Chapter 9*).

Minimal Frameworks

1.22 The following agencies' internal audit frameworks included few, if any, significant better practices:

- Department of Justice and Community Safety (see *Chapter 8*); and
- Department of Health and Community Care (see *Chapter 7*).

1.23 In response to drafts of this Report, all agencies with reasonable or minimal frameworks advised that they had undertaken, or intended to undertake, significant improvements to their frameworks.

No Internal Audit Function

1.24 The following agencies did not have an internal audit function:

- Public Trustee (see *Chapter 13*); and
- ACTTAB (see *Chapter 17*).

1.25 In response to a draft of this Report ACTTAB advised it has taken action to form an audit committee and appoint an internal auditor. The Public Trustee has advised of steps being taken to review its governance processes.

Framework Being Developed

1.26 The internal audit framework for the Kingston Foreshore Development Authority was being developed over the period of the conduct of the Audit. The Authority is reasonably advanced in establishing a generally sound framework. The framework is not yet fully operational (see *Chapter 12*).

CHIEF EXECUTIVES RESPONSES

1.27 In accordance with section 18 of the *Auditor-General Act 1996*, a proposed report of the Audit was provided to the Chief Executives of all

agencies included in the Audit. The specific comments, which the chief executives wished to have included in the Report, are recorded in the respective chapter for each agency.

1.28 Overall the chief executives' responses were positive and advised of the implementation of actions to improve existing internal audit frameworks or made undertakings to improve their frameworks.

1.29 Some departmental Chief executives did not agree with the better practices identified in this Report for audit committee membership or for audit committee reporting lines. Their views are summarised in the future actions section of this Chapter together with the Audit comments on their views (see *paragraphs 1.32 to 1.54*). The individual chief executive's comments are quoted in their agency chapter.

FUTURE ACTIONS

1.30 The Audit showed that most agencies' internal auditing frameworks needed to be improved. The following suggestions for future actions are presented as better practice guidance for internal auditing frameworks in Territory agencies.

Audit Committees

1.31 Audit committees give special attention to important components of agencies' governance processes including agencies' financial, compliance and risk management systems. They are also essential to the effective and independent operation of the internal audit functions which assess these systems. Audit committees in agencies are at various stages of development ranging from being well developed to non-existent.

Suggested Action 1 – Agencies that do not have an audit committee should establish an audit committee.

Audit Committee Membership - Departments

Need for Independent Membership

1.32 The Audit found that for all departments, which had audit committees, the majority of audit committee members and audit committee chairpersons are agency senior executives. These executives therefore participate in audit committee decisions on audits of operational activities which they themselves manage.

1.33 All authoritative better practice guides for audit committees

reviewed by the Audit emphasise that chairpersons and members of committees should be external to the organisation and not be involved in either the operational management of the organisation or in consulting to the agency. Many of the benefits generated by an audit committee stem from the committee being an independent and objective forum. It is the external membership and chairpersonship of an audit committee which establishes its independence.

1.34 A risk from an audit committee dominated by members from within an agency has been identified by the New South Wales Treasury as:

If internal auditors bring to light weaknesses or deficiencies through an audit finding, and the audit committee is comprised of members from within, they may be affected by their direct involvement in the problem areas. On the other hand, an audit committee made up of members outside the agency's management structure would be more apt to be impartial and objective in such matters.

1.35 Other forms of risks exist including that committee members may exert influence over the scope, objectives and resources applied to audits directed at the areas they manage.

1.36 In its 1996 report on Ministerial portfolios 1996, the Victorian Auditor-Generals' Office expressed its opinion in clear support of the principle of an independent audit committee in order to maintain a reasonable degree of independence and separation from management influence.

1.37 The Audit considers that an audit committee comprised of senior executives from within the agency may not be consistently impartial (or at least be perceived to be impartial) in its deliberations about operations which the members themselves manage.

1.38 The Audit also has the view that a committee dominated by agency senior executives is not an audit committee although it may review issues which are similar to those which an audit committee addresses. In theory, and in substance, a committee dominated by management is a management committee and not an audit committee.

Departmental Views – ANAO Better Practice Guide

1.39 The Australian National Audit Office (ANAO) released a report

and better practice guide in 1997 on Commonwealth agencies' audit committees.

1.40 In advising of their view that departmental audit committees should comprise predominantly internal managers three ACT departments² made reference to the ANAO better practice guide. The departments quoted or referred to a statement in the ANAO guide as follows:

For a governance model that places sole responsibility and accountability for an entity with a single position (ie the chief executive), an audit committee comprised of a majority of members from outside the organisation may not be appropriate.

The audit committee will be drawn mainly from the management of the entity. This does not preclude inviting an 'outside' representative on to the committee to provide an external perspective or perhaps to bring to the committee skills and knowledge it does not otherwise possess.

1.41 The statement referred to by the departments is immediately followed in the ANAO guide by another related statement. The related statement is as follows.

In either case the committee will not be 'truly' independent and, perhaps more importantly, will not be perceived to be independent.

It is important to understand the inherent limitations the lack of independence can create and, as referred to previously, to modify the committee's role and responsibilities accordingly.

1.42 The ANAO report included:

The majority of audit committees operating in departments and similar entities are comprised of the executive management of the entity. As such by definition, they are not and cannot be truly independent.³

² The responses from Treasury and Chief Minister's Departments relate to their joint audit committee.

³ Australian National Audit Office, Audit Committees June 1997, page 3.

1.43 The ANAO guide includes:

Such a committee cannot provide the same type or degree of benefits as a committee with a majority of external independent members.

1.44 A main thrust of the ANAO report and the accompanying guide is that audit committees should be independent. The ANAO report concedes that in the specific case of Commonwealth departments an audit committee with a majority of external members may not be inappropriate. ANAO, however, makes it clear (see quotes in paragraphs 1.41 to 1.43) that ANAO views audit committees with predominantly internal membership as having significant limitations.

Departmental Views – AARF Guidance

1.45 The Australian Accounting Research Foundation (AARF) has also issued advice on audit committee membership. The advice includes:

External members bring to the Audit Committee skills, knowledge and experience that may not be otherwise available from within and a facility for checks and balances to the primarily internal focus of other members. In this regard, members of the LGE (Local Government Entity) are not regarded as independent as they are part of the policy and decision making process, and have responsibilities within the internal processes which will be subject to review by the Audit Committee⁴.

1.46 Parts of the AARF guidance were interpreted by some ACT departments in their responses to drafts of this Report as supporting a view that public sector audit committees should be comprised predominantly of people from within the agency and chaired by the departmental chief executive.

1.47 The AARF comment on board audit committee membership which the departments identified to the Audit as supporting their view is as follows:

In certain circumstances, for example, the public sector, it may be appropriate to appoint independent individuals to the committee who are not directors but have significant expertise of

⁴ Australian Accounting Research Foundation, Best Practice Guidelines Local Government Entity Audit Committees and Internal Audit; June 2000, page 8.

*value to the committee while limiting their number to a minority of committee members”.*⁵

1.48 The Audit notes that the main emphasis of AARF’s document from which the comment was drawn is consistently in support of the principle of an independent and objective audit committee achieved through an external chairperson and external members of the committee. In the Audit view the AARF Guidance, taken as a whole, does not support departments’ interpretations that departmental audit committees should consist predominantly of agency employees.

Departmental Views – Need for Senior Management Knowledge

1.49 In support of their view that department audit committees needed to be predominantly comprised of internal members two departments stated that it was essential that departmental managers be members of audit committees in order that committees have access to the managers’ knowledge of the departments’ operations. While the committee’s need for managers’ knowledge is appreciated, having managers as committee members is not the only method by which committees can access this knowledge. A very common practice is for audit committees to invite internal managers to audit committee meetings when the managers’ knowledge is relevant to the matters being considered.

Audit Comments

1.50 The Audit is of the view that the principle of external membership of audit committees is as important for the audit committees of government departments as it is for statutory authorities, government owned corporations and public companies. External membership is the cornerstone of the independent support that the audit committee can give to the internal audit function as well as its deliberations on other matters.

1.51 To achieve independence it is important for the chairperson of departmental committees to be an external member. In this regard it is pleasing to note that the Chief Minister’s Department, Treasury Department, Department of Education and Community Services and the Department of Health and Community Care in their responses to drafts of the Audit report advised that they proposed to appoint independent chairpersons for their audit committees. The Department of Urban Services has advised, however, that it will not be appointing an external

⁵ Australian Accounting Research Foundation, Best Practice Guide Audit Committees, August 2001, page 12.

member as chairperson. The Chief Executive will continue as chairperson.

1.52 As previously explained, as well as the chairperson being an external member, it is also important for the proportion of external members to be sufficient in number to ensure that audit committees can act independently and objectively and be perceived as acting independently and objectively. The number of external members needed will be dependent on the size of the committee. For example, if a committee has three to five members (see *Chapter 2*), two or three external members including the chairperson would be sufficient. A large committee of nine members would need four or five external members.

Suggested Action 2 – Audit committees should have chairpersons who are external to the departments and who have no decision-making or consulting responsibilities to the departments.

Suggested Action 3 – Departmental audit committees should have a majority of members or close to a majority of members, who are external to the agency. These persons should have no decision-making or consulting responsibilities to the agency. A majority, or close to a majority, should be readily achievable if existing large committees were reduced to the better practice size of three to five members.

Audit Committee Reporting Lines - Departments

1.53 The Audit noted that Departmental audit committees report only to departmental chief executives.

1.54 In *Chapter 3* it is explained that Ministers have governance responsibilities for departments. These include responsibilities for the financial and other performance of departments. Audit committee functions include reviewing the results of audits of departments' financial and other performance. Audit committees are therefore very well placed to independently inform Ministers on matters for which they have governance responsibilities. The following *Suggested Action 4* is intended to assist Ministers in meeting their governance responsibilities.

Suggested Action 4 – Departmental audit committees should have a reporting line to the portfolio Minister. The audit committee chairperson should formally report at least annually to the Minister on the audit committee's activities. The chairperson's report could also be included in the department's annual report.

Audit Committee Charters

1.55 Audit committees should have formal charters to facilitate and guide their efficient and effective operation. Charters provide essential guidance on the roles, objectives and responsibilities of audit committees including the committees' role in supporting and monitoring the internal audit function.

1.56 Audit committee charters in Territory agencies are of varying quality, ranging from being well developed to non-existent.

Suggested Action 5 – Agencies that do not have an audit committee charter should develop and endorse a formal charter. Those agencies with an existing charter should ensure that the charter is regularly reviewed. In all cases charters should incorporate the better practices outlined and referred to in *Chapter 2*, and other relevant guidance, for example, *The Best Practice Guide for Local Government Entity Audit Committees and Internal Audit* prepared by the Australian Accounting Research Foundation.

Internal Audit

1.57 Internal auditing helps an agency accomplish its objectives by systematically evaluating and providing assurance of the effectiveness of governance processes. Internal auditing in Territory agencies is of varying stages of development, ranging from being well developed to being non-existent.

Suggested Action 6 – Agencies that do not have an internal audit function should create one. Those agencies with an existing function should ensure that the capacity of their function is regularly reviewed. In all cases functions should incorporate the better practices outlined and referred to in *Chapter 2*, and other guidance relevant to the operation of internal audit.

Internal Audit Charter

1.58 It is important for agencies' internal audit functions to have formal charters to confirm their role and to assist with their efficient and effective operation. These charters form an important record and provide guidance on the role, scope, objectives, and responsibilities of internal audit and especially those essential better practices, which assist the independence of the internal audit function. For example, the internal auditor must have unlimited access to information and the support of the

audit committee.

1.59 Internal audit charters in Territory agencies are of varying quality, ranging from being well developed to being non-existent.

Suggested Action 7 – Agencies that do not have an internal audit charter should develop a formal internal audit charter. Those agencies with an existing charter should ensure that their charter is regularly reviewed for its effectiveness. Agencies' internal audit charters should be approved by the audit committee. The charter should be endorsed by the chief executives in the case of departments and by governing boards in the case of statutory authorities and Territory owned corporations. The charters should incorporate the better practices outlined and referred to in *Chapter 2*, and other relevant guidance.

Internal Audit Resources

1.60 This Audit compared the expenditure on internal auditing by selected Territory agencies with the expenditure on internal audits by other Territory agencies and the expenditure on internal auditing by Commonwealth agencies. There is a wide variation in the expenditure on internal auditing between Territory agencies. Territory agencies' expenditure on internal auditing in general is much less than it is for Commonwealth agencies.

1.61 Because of the limited methodology necessarily used by the Audit to assess Territory agencies internal audit resources the results provide only general guidance on the adequacy of resources being applied to internal audit by Territory agencies.

1.62 Territory agencies with relatively large expenditure, turnover or investments were selected for assessment of resources applied. Agencies from a representative sample of Commonwealth agencies were compared with the selected Territory agencies.

1.63 The Commonwealth and Territory agencies compared had similar sized expenditure.

1.64 Further information on the comparison methodology used and the results is contained in *Appendix B* to this Report.

1.65 The comparisons indicated that some Territory agencies spend only minor amounts on internal auditing and that Territory agencies' expenditure on internal auditing in general is much less than that of

Commonwealth agencies.

Suggested Action 8 – Territory agencies should assess if their current expenditure on internal auditing is adequate.

Absence of Various Better Practices

1.66 In most agencies the Audit identified several departures from better practices. The significant departures are described in the agency chapters in the later sections of this Report. It should be noted that departures described in the Report do not necessarily represent all departures.

Suggested Action 9 – Each agency should identify and address departures from the better practices identified in this Report.

Future Reviews

1.67 This Report describes the existing state of internal audit frameworks in Territory agencies. As frameworks will change there is a need to regularly review that sound practices existing now, or to be introduced in the near future, are maintained over the longer term.

Suggested Action 10 – At regular intervals agencies should compare their practices with the better practices set out in *Chapter 2* and take corrective action as necessary.

Public Sector Management Standards

1.68 The Audit reviewed the guidance on internal audit functions contained in the *Public Sector Management Standards*. The review revealed that the Standards refer to arrangements for internal audit functions, which have been out of date for several years.

Suggested Action 11 – The *Public Sector Management Standards* should be amended to provide accurate and current guidance for internal audit functions. *Chapter 2* should be taken to account when formulating these amendments.

CONCLUSION

1.69 The Audit found that most agencies' internal auditing frameworks did not include the full range of better practices. The Audit formed an overall opinion that frameworks as they existed were not adequate to effectively contribute to the good governance of Territory agencies.

1.70 It is acknowledged and appreciated that most agencies have already proposed actions to strengthen their internal auditing frameworks. Notwithstanding such actions most agencies will need to further improve their frameworks if internal auditing is to make a fully effective contribution to good governance.

1.71 Before agencies complete implementation of actions to strengthen their frameworks reference should be made to the full range of better practices listed in *Chapter 2* of this Report. Each listed better practice should be considered for implementation.

2. A BETTER PRACTICE FRAMEWORK

INTRODUCTION

2.1 The Audit examined guidance and standards issued by the Institute of Internal Auditors – Australia, better practice of the Australian Accounting Research Foundation and better practice guides of the Australian National Audit Office and the New South Wales Treasury.

2.2 Embodied in these authoritative standards and guidelines are better practices for the conduct of internal audit functions. These better practices are aimed at providing an environment conducive to effective internal audit functions. They are as applicable to the public sector as they are to the private sector.

2.3 From its examination of the standards and guidelines the Audit developed a set of better practices for internal auditing frameworks. The better practices which the Audit identified as being of significance to the conduct of this Audit are summarised in this Chapter.

BETTER PRACTICES IDENTIFIED

Audit Committees

2.4 The key objective of an audit committee in respect of internal audit is to provide a structured reporting line for internal audit and facilitate the maintenance of objectivity in the internal audit. The better practices of an audit committee include the following.

Membership Composition to Enhance Independence

- The Chair of the audit committee will be from outside the agency and will have no management or consulting involvement with the agency.
- The majority of members of the audit committee will have no management or consulting involvement with the agency.
- The Audit committee will have at least three and no more than five members.
- The terms of appointment of members should include the details of their roles and responsibilities as audit committee members.

Audit Committee Charter – Terms to Assist Effectiveness

- The audit committee will have a formal charter or terms of reference which clearly identifies the committee’s powers and responsibilities.
- Meetings of the audit committee will be held at least four times per year. Minutes will be formally recorded and they will be endorsed by the Chairperson.
- An Audit Committee’s responsibilities will include the oversight of the internal audit function, reviewing the internal auditor’s mission statement, charter and resources, approving and monitoring the internal audit plan as well as monitoring management’s responses to internal audit’s findings.
- The audit committee will regularly assess the internal audit function for effectiveness and efficiency and the benefits being provided to the agency.
- The quorum for audit committee meetings will be formally stated as a minimum of two independent members.
- The head of the internal audit function will attend all the meetings of the audit committee.

2.5 An example of the full range of responsibilities of an audit committee are provided as *Appendix A* to the Report.

Training for Audit Committee Members

2.6 Audit committee members should be provided with training. Such training would include the following topics as necessary:

- responsibilities of committee members;
- the agency, its aims, objectives, key policies, and procedures, key personnel and current issues;
- business planning and annual reporting processes and practices;
- public sector values and standards of probity and accountability;
- the policy and administrative environment in which the agency operates including relevant legislation and central agency guidance;
- control environment and control activities;
- delegation arrangements; and

- budgeting, planning and performance arrangements.

2.7 Members of audit committees will be from varying backgrounds with a variety of professional skills and knowledge. It is likely that all new members will need some form of training to enhance their contribution to the committees.

2.8 It is likely that training for external committee members would be concentrated on agency specific matters while internal members may need to be trained in areas of general management outside their normal expertise.

Internal Audit

2.9 Internal control is a critical element of agency governance. A key objective of internal audit is to provide assurance concerning the effectiveness of internal control systems. Important better practices for internal audit follow.

Suitable and Adequate Resources

2.10 To enable an appropriate framework for internal audit to produce good results it is important that the internal audit receives suitable and adequate resources. Important better practices to resource internal audit include.

- Processes to engage contracted internal audit resources will follow better practice principles for procurement of professional services.
- The experience and qualifications of auditors engaged to conduct an audit will be relevant to the subject being audited.
- Auditors will be provided with regular training, relevant to the topics being audited.
- Auditors will have relevant formal qualifications and professional membership.
- A regular appraisal will be made of whether the expenditure on the internal audit function is adequate.

Reporting Lines to Avoid Potential Conflicts

- The manager of the internal audit function will not have significant responsibilities for areas that are frequently the subject of internal auditing.

- Mechanism will be in place to compensate for any potential conflicts if the preceding reporting line cannot be avoided.

Internal Audit Charter – Terms to Assist Effectiveness

- The internal audit function will have a charter endorsed by the Chief Executive and the audit committee.
- The internal auditor will have direct access to the audit committee and the chief executive.
- The internal auditor will provide reports directly to the audit committee and will account for the operations and performance of the internal audit function to the audit committee.
- Free access by the internal auditor to records and personnel relevant to audits will be specified in the internal audit charter.
- The internal audit charter will specify that internal audit is not to audit its own work and that the internal audit function is not to perform management responsibilities.
- Mechanisms and frequencies for the review of the internal audit function will be specified in the charter.

Comprehensive Planning and Monitoring

2.11 Long term plans annually reviewed from a short and long term perspective are an effective means of ensuring audit efforts are aligned to the long term strategies of the agency as well as taking short term changes effecting the agency into account. They also ensure that all important areas receive audit coverage over time. Important better practices for planning and monitoring internal audits follow.

- Agencies will have long-term audit plans endorsed by the Chief Executive and audit committee.
- Internal audits will have a wide focus, which includes economy, effectiveness, agency outputs, environmental matters and the agencies and employees compliance with policies and legislation.
- Topics, which are of key importance to the agency's primary responsibilities and focus, will form the basis of the long-term audit plan.
- The long-term audit plan will incorporate assessments of risk, including environmental risk, and other key strategies of the agency.

- Internal audit will consider line management's perspectives in developing audit plans.
- Audit committee procedures will be formalised and endorsed to monitor progress with the long-term audit plan.
- Quality control procedures will be in place to gauge the effectiveness of audit activities and peer reviews of the internal audit function will be regularly conducted.

Endorsed Reporting and Implementation Procedures

2.12 To ensure that the benefits of internal audit are realised it is important that the findings of internal audits are reported in a readily understood format, to an independent forum and appropriate actions are taken to address the findings. Important better practices for reporting and implementing internal audit findings follow.

- Endorsed and formal procedures will be in place for the progressive reporting of audit findings to the audit committee.
- A formal reporting format will be endorsed; the format will promote clarity, completeness and understanding of audit reports.
- Formal and endorsed procedures will be in place for final audit reports to be issued to the audit committee as well as managers, stakeholders and the chief executive.
- Formal and endorsed procedures will be in place to ensure that audit findings are addressed. These procedures will identify the manager responsible for implementation, proposed action and a timetable for implementation of actions to address findings and recommendations.

SECTION B

DEPARTMENTS AND CANBERRA INSTITUTE OF TECHNOLOGY

This section of the Report includes an introductory chapter on internal audit functions and departmental governance. The remaining chapters present the results of the audit of the internal audit frameworks in the departments listed below and a statutory authority with similar governance arrangements to those of the departments:

- Chief Minister's and Treasury;
- Urban Services;
- Education and Community Services;
- Health and Community Care;
- Justice and Community Care; and
- Canberra Institute of Technology.

3. INTERNAL AUDIT AND DEPARTMENTAL GOVERNANCE

INTRODUCTION

3.1 This Chapter briefly outlines the legislated governance arrangements for Territory departments and for the Canberra Institute of Technology. The relationship of internal audit functions, including audit committees, to governance is also discussed.

3.2 The Canberra Institute of Technology has been included in this section of the Report due to the similarity of the Institute's governance arrangements with department arrangements. Any reference made to departments in this section of the Report is also intended to be applicable to the Institute.

LEGISLATED GOVERNANCE ARRANGEMENTS FOR DEPARTMENTS

3.3 The *Australian Capital Territory (Self Government Act) 1988* provides, at *section 43*, that "a Minister shall administer such matters relating to the powers of the Executive as are allocated to that Minister from time to time by the Chief Minister". The allocation of ministerial responsibility for administrative units (departments)⁶ is provided for in *section 14* of the *Public Sector Management Act No 37 1994* (the Act).

3.4 *Section 29* of the Act provides for the establishment of departments and for a Minister to be responsible for one or more departments. The Act also provides for chief executives under the relevant Ministers to be responsible for the administration and business of departments.

3.5 *Section 28B* of the Act states that Ministers have governance responsibilities for their departments. That section provides that Ministers are responsible for:

- (a) the policies developed or applied by the administrative unit; and
- (b) the financial and other performance of the administrative unit.

⁶ An administrative unit is generally a department or part of a department.

3.6 The Act provides that Government agencies have an objective of implementing certain values and principles. These values and principles include efficiency, effectiveness and accountability to the government for the ways in which functions are performed and that better management practices shall be used.

3.7 Section 31 of the *Financial Management Act 1996* provides that:

The responsible chief executive of a department shall be accountable to the responsible Minister of the department for the efficient and effective financial management of the department.

3.8 Chief executives' responsibilities include ensuring that adequate control is maintained over the assets and liabilities of the department and the department's accounting systems.

3.9 *Better Practice Note 6.3 – Management*⁷ identifies that chief executives are accountable to the Minister for the performance of the programs which they administer through the departments under their control.

Audit Comment

3.10 The legislation briefly described in the preceding paragraphs makes it clear that both chief executives and Ministers have responsibilities for the governance of departments. *Chapter 3* of Auditor-General's Report 2 of 2001 titled *Enhancing Professionalism and Accountability* contains further discussion on the responsibilities of Ministers and Chief Executives for departmental operations.

DEPARTMENTAL GOVERNANCE AND INTERNAL AUDIT

Departmental Governance Generally

3.11 Governance can be referred to as the processes by which departments are directed, controlled and held to account⁸. Governance processes are the structures, systems and internal controls used to ensure that the department is performing efficiently and effectively as well as

⁷ Best Practice Notes are issued by the Chief Minister's Department. The Notes aim to provide advice to managers and staff of the ACT Public Service on best practice. They can provide information and advice on the processes, practices and responsibilities required by the *Public Sector Management Act*.

⁸ ANAO Discussion Paper, *Corporate Governance in Commonwealth Authorities and Companies*, July 1999.

conforming to legislation and guidelines.

3.12 As chief executives and Ministers may not be directly involved in the detailed functions of a department but remain responsible for the governance of the department they must rely on internal controls, systems and delegated authority. Effective governance processes should enable the chief executive and Minister to provide the directions necessary throughout the agency to achieve desired outcomes and obtain accurate and reliable feedback on the department's performance.

Internal Audit Contribution to Governance

3.13 Internal audit functions can provide assurance of the adequacy and effectiveness of a department's governance processes. For example, an internal audit can review whether adequate systems are in place to ensure that the department is complying with all relevant legislation and whether any existing systems for legislative compliance are working effectively. An internal audit can also provide assurance as to whether the department's organisational structures facilitate efficiency and operate effectively. Internal audits can also focus on individual aspects of a Department's activities, the provision of a particular service for example or the department's performance in addressing social and environmental issues.

Independent Audit Committees

3.14 The internal audit function's role in relation to governance processes will be more effective if an independent audit committee exists. An audit committee's independence will be enhanced by having a chairperson who is not involved in the management decisions of the agency. An independent audit committee furnishing a report to Ministers on the results of internal audit activities for the year would assist the Ministers in meeting their governance responsibilities.

CONCLUSION

3.15 Under legislation Ministers and chief executives have governance responsibilities for the operation of departments. An effective internal audit framework can assist the chief executive and the Minister by providing assurance that governance processes are adequate and functioning properly. An audit committee is a valuable support to the internal audit function. The powers of audit committees are strengthened if the committees have independent chairpersons and have reporting lines to Ministers.

4. CHIEF MINISTER'S DEPARTMENT AND DEPARTMENT OF TREASURY

INTRODUCTION

4.1 This Chapter presents the results of the audit of the framework for internal auditing in the Chief Ministers Department and the Department of Treasury. The departments participate in a joint internal audit function. Comments made in this Chapter refer to the joint function.

4.2 Contractors perform most of the departments' internal audit work. A middle level employee coordinates the internal audit function and conducts some audits. The middle level employee reports to the Director of Corporate Services, Chief Minister's Department.

THE DEPARTMENT'S INTERNAL AUDIT FRAMEWORK

4.3 The Audit compared the departments' framework, as it existed during the initial stages of the audit, with the audit identified better practices. The comparison showed the following.

Audit Committee

4.4 *Existence* – The departments have a joint audit committee.

4.5 *Audit Committee Membership* – The joint audit committee has a majority of internal members (i.e. departmental employees) all of whom manage significant departmental activities. The chair of the audit committee is a senior executive of the Treasury Department who also has management responsibilities.

4.6 *Audit Committee Charter* – There is a formal and endorsed audit committee charter.

4.7 The Audit noted that the committee's objectives as outlined in the charter included matters that should be the responsibility of management and the internal auditor.

4.8 The audit committee charter does not include statements making it clear that the internal audit function has direct access to and the support of the chief executive and audit committee. The Audit notes that it is an essential better practice for the internal audit to have direct access to the chief executive and the audit committee.

Audit Comment

4.9 The departments have an audit committee operating, however, several better practices in relation to roles and membership of the audit committee are not in place. Some documentation relevant to the committee could be improved to bring it to better practice.

4.10 In relation to audit committee membership an important principle is that audit committee members should not have the potential to influence audit activity over areas they manage. With departmental managers on the committee this potential exists. As currently constituted most audit committee members manage areas that would be expected to be the subject of internal audits. In addition, the committee as currently constituted is unlikely to be perceived as being independent or impartial.

Internal Audit

4.11 *Existence* – There is an internal audit function.

4.12 *Resources* – The audit committee approves the selection of contract auditors. The qualifications of internal audit contractors' staff are assessed to determine if they match the requirements of individual audit projects. The Audit notes that procurement of contract audit services has been conducted in accordance with better practice.

4.13 The departments' expenditure on internal audit was in the lower range of expenditures by Territory agencies for the three years 1998 to 2000. Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1* of this Report.

4.14 *Reporting Line* – The employee who coordinates the internal audit function reports to the Director of Corporate Services. The Director is responsible for the management of contracted internal audit services.

4.15 It would be expected that the corporate services area would be regularly reviewed by internal audit. A potential conflict may arise as the Director of Corporate Services would be in control of the internal audit of the corporate services area while at the same time managing the area. For this reason it is not sound practice for the Director of Corporate Services to manage the internal auditor or internal audit contractors unless there is some compensating mechanism in place to address the

potential conflict of interest situation when internal audits of corporate services activities are being planned and conducted.

4.16 *Internal Audit Charter* – There is a formal endorsed internal audit charter.

4.17 *Planning and Monitoring* – At the time the audit was completed a long-term audit plan had been prepared based on an informal risk assessment. The departments are in the process of developing risk management capabilities within the agencies.

4.18 Neither the departments, nor the contract internal auditors have conducted quality assurance procedures to gauge the effectiveness of the internal audit function.

4.19 *Reporting and Implementation* – There were no formally endorsed procedures for ensuring the implementation of actions to address findings made in internal audit reports. The audit committee has since committed to compiling a register.

SUMMARY

4.20 The departments have an audit committee and an internal audit function. The internal audit framework, however, did not incorporate a range of better practices. The Audit view based on the framework existing in the early stages of the audit was that the framework should be significantly improved.

4.21 The departments have advised that a number of better practices which will contribute to improving the framework are in the process of being implemented. The framework has recently been amended to incorporate a range of better practices. The amendments include:

- the departments have recently formalised and endorsed audit committee and internal audit charters;
- the departments have recently introduced improved planning procedures; and
- better practice procedures for the procurement of out-sourced internal audit resources have been followed.

4.22 The following issues remained to be addressed at the conclusion of the Audit.

- (a) The departments' audit committee is chaired by a senior executive and comprised of a majority of members who are departmental employees and who are directly involved in the departments' management. The framework would be improved if the proportion of external members was increased and an external member was the chair.
- (b) Compensating mechanisms should be identified and implemented to address the issue of the internal audit being the management responsibility of the Director of Corporate Services.
- (c) The audit committee responsibilities included matters that should be the responsibility of management and the internal auditor.
- (d) The departments had no formal endorsed procedures for actions to be taken to address internal audit report findings.
- (e) Better practices remained to be formalised for reporting formats and quality assurance.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE

4.23 The views of the Chief Executive Chief Minister's Department were sought as to how much assistance was provided by the function.

4.24 The Chief Executive expressed the view that he was not satisfied with the performance of the internal audit function as it had operated in previous years. The Chief Executive indicated that he was implementing plans to expand and develop the internal audit function.

Audit Comment

4.25 The comments by the Chief Executive indicate his view that the internal audit function was previously insufficient.

4.26 The audit's assessments of the internal audit framework provide confirmation of the views expressed by the Chief Executive.

DEPARTMENTAL RESPONSES

Initial Response

4.27 In responses to a preliminary draft of this Report received in February 2002 the Chief Executives of the Treasury and Chief Minister's Departments advised of a number of initiatives to improve their joint internal audit framework as follows.

- The departments have amended their Audit Committee Charter to appropriately describe the role of the audit committee as “*assessing the adequacy*” of management controls. (see *paragraph 4.22(c)*)
- The departments acknowledged that the corporate services area would be regularly reviewed by the internal audit and that a potential conflict may arise if the Director of Corporate Services was in control of the internal audit of the corporate services area. The department has proposed as a compensating mechanism that when internal audit reviews are conducted in Corporate Services, the findings will be directly reported to the Chair of the audit committee, the Deputy Chief Executive and the Chief Executive. (see *paragraph 4.22(b)*) A further improvement would be for the proposed mechanism to be extended to the planning phase of internal audits of the Corporate Services area.
- It is the intention of the departments to amend the audit committee charter to include a provision for the periodic monitoring of the audit committee’s performance – an accepted quality assurance better practice. (see *paragraph 4.22(e)*)
- The departments have acknowledged that the internal audit framework could be improved and is proposing to appoint an independent chairperson who is not involved in the management processes of the agency. (see *paragraph 4.22(a)*)
- The departments have committed to compiling a register, which incorporates formal endorsed procedures for ensuring the implementation of actions to address findings made in internal audit reports. (see *paragraph 4.22(d)*)
- The departments have increased their budget for the internal audit function in 2001-2002 by more than double that of the preceding year.

Chief Minister’s Department Final Response

A response dated 4 June 2002, to the proposed report was received from the chief executive of the Chief Minister’s Department. The response included:

“Subject to the two exceptions addressed below, I support the suggested actions set out in the Report. The operation of effective internal audit functions and a properly constituted internal audit committee make a significant contribution to good governance and management within an agency. The joint CMD /Treasury Internal Audit Committee materially assists me in fulfilling my obligations under the Financial Management Act and the Public Sector Management Act.

Suggested Action 3 [see Chapter 1] that departmental audit committees should have a majority of members external to the agency is not supported. While such an approach may be more common in the commercial sector, there is a lack of agreement in authoritative guidance regarding the ideal structure for composition of public sector audit committees. While the appointment of an independent chair is supported and is being adopted for the CMD / Treasury committee, it is neither practicable nor desirable to have a majority of external members on a committee whose role, after all, is to advise the chief executive. The contribution of agency senior executives is important both to provide expertise on the nature of departmental activities, procedures and priorities as well as to demonstrate the importance of the internal audit function within the department.

Suggested Action 4 [see Chapter 1] that Departmental audit committees should have a reporting line to the portfolio Minister is also not supported.

Although it is recognised that a Minister has overall responsibility for the financial and other performance of an administrative unit, it is the Chief Executive who has responsibility for operating responsibilities within an administrative unit. As a result, it is considered appropriate for Audit Committees to continue reporting directly to the Chief Executive.

This suggestion confuses the appropriate role of such audit committees which is to assist the Chief Executive in the discharge of his or her responsibilities. External scrutiny and reporting is appropriately provided by the Auditor General and by the activities of relevant Assembly Committees.

In this regard, I note that Australian Auditing Standard 604 (Considering the Work of Internal Auditing) distinguishes the separate roles of both the internal and external auditors. In regard to the role of the internal and external auditor, it states the following:

“.06 The role of internal auditing is determined by management, and its objectives differ from those of the external auditor who is appointed to report independently on the financial report.”

and

“.08 Internal auditing is part of an entity. Irrespective of the degree of internal auditing’s autonomy and objectivity, it cannot achieve the same degree of independence as required by the external auditor when expressing an opinion on the financial report.”

Both of these references indicate that internal audit is a function to operate within the agency to provide assurance to senior management, including the Chief Executive, of the operation of effective controls and the proper performance of functions. It follows that accountability lines should also operate within the agency.

I therefore consider that an internal audit committees should report to the Chief Executive, with the Chief Executive then being held accountable to the relevant Minister for the agency’s operations.

Treasury’s Final Response

A final response dated 24 May 2002, to the proposed report was received from the chief executive of the Treasury Department. The chief executive drew attention to two specific issues.

Composition of Audit Committees – It is considered that the report does not fully represent the lack of a commonly agreed ideal model for composition of audit committees in the public sector.

It is noted from the report that there exists a lack of agreement in authoritative guidance regarding the ideal structure for composition of public sector audit committees. Regarding this issue, agency senior executives are often motivated for internal audit review as a means of providing additional assurance in regard to the operation of controls and effective practices. It is also considered that agency senior executives can have a higher level of commitment than external members in the obtaining of practical and cost effective audit recommendations. It is unclear as to how effective in the public sector a majority of independent members on audit committees would be in identifying the key risk areas for audit attention.

Reporting by Internal Audit Committees - The Department does not agree with the Suggested Action 4 [see Chapter 1]. Although it is recognised that a Minister has overall responsibility for the financial and other performance of an administrative unit, it is the Chief Executive who has responsibility for operating responsibilities within an administrative unit. As a result, it is considered appropriate for Audit Committees to continue reporting directly to the Chief Executive.

This proposal also appears to confuse the responsibilities of the internal and external auditor. The internal audit function exists within an entity to provide assurance to senior management, including the Chief Executive, of the operation of effective controls and the proper performance of functions. As a result, it is considered that responsibility lines for an Audit Committee should remain with an administrative unit, and not as proposed, to either a Minister or Legislative Assembly committee.

Apart from the two issues addressed in this response, the report is considered to be beneficial in progressing the effective use of internal auditing within the Territory.

Audit Comment on the Departments' Responses

4.28 The Audit welcomes the departments' positive responses and the proposals and actions to improve the internal audit framework. Implementation of several better practices is in progress. When these better practices are fully implemented the framework for internal auditing will be significantly improved.

4.29 The departments did not agree with the Audit's view that the department's joint audit committee would be improved if the proportion of external members on the committee was increased, or the Audit view that audit committees should have reporting lines to Ministers. The Audit's views in relation to the importance of independent membership of audit committees and committee reporting lines are set out in *Chapter 1*.

4.30 Some specific comments are provided following in relation to the chief executives' responses.

4.31 The chief executives' responses argue against a majority of independent members on their audit committee. The department's joint audit committee currently has nine members. This would mean that for a majority to be created five independent members would be necessary. If the size of the departments' audit committee was to be reduced to the better practice of between three to five members (see *Chapter 2*), only two to three independent members would be necessary to satisfy the objective of independence. The departments have undertaken to appoint an independent member as chairperson. Therefore the department would have to appoint only one or two additional independent members if the committee was reduced to better practice size. This should be readily achievable.

4.32 The Treasury chief executive has stated that independent members will not be as effective as agency senior executives in identifying key risk areas for audit attention. This view is understood, however, identifying key risk areas does not require that agency senior executives be committee members. A common practice is for risk assessments to be performed by internal auditors or consultants who, as one of their information sources, obtain the views of agency senior executives in the identification of key risks. The key risks are then incorporated into an audit plan for submission to the audit committee.

4.33 The Audit agrees with the chief executives' comments that a Minister has overall responsibility for the financial and other performance of an administrative unit and the Chief Executive has responsibility for operating responsibilities within a department.

4.34 The Audit's *Suggested Action 4* relating to audit committees reporting to Ministers, which the chief executives do not agree with, does not mean that the departments' committee will not provide reports to chief executives. The suggested reporting line to the Minister is in addition to reports being provided to chief executives.

4.35 In *Chapter 3* it is explained that Ministers have governance responsibilities for departments. These include responsibilities for the financial and other performance of the departments. The *Suggested Action 4* is intended to assist Ministers in discharging their governance responsibilities. As audit committee functions include reviewing the results of audits of departments' financial and other performance the committees should be very well placed to independently inform Ministers on matters for which Ministers have governance responsibilities.

4.36 The chief executives' responses point out that the chief executives have responsibility for operations within administrative units. The Audit agrees. Chief executives, however, are responsible to Ministers for their department's operations. It is not unreasonable therefore for Ministers to have access to independent and available sources of information on the chief executives' discharge of their responsibilities.

4.37 The chief executives have distinguished between internal and external audit responsibilities in responding to *Suggested Action 4*. The Audit agrees that there are differing roles for internal and external auditors. *Suggested Action 4*, however, relates to audit committees and not to the internal audit function. Differences between internal and

internal audit roles are not relevant to the Audit's suggestion.

4.38 The Audit has carefully considered the comments provided by the two chief executives. However the Audit maintains the view that independence of audit committee membership and committees having reporting lines to Ministers are essential components of a fully effective departmental internal auditing framework.

5. DEPARTMENT OF URBAN SERVICES

INTRODUCTION

5.1 This Chapter presents the results of the audit of the framework for internal auditing in the Department of Urban Services. ACT Housing, ACT Forests and ACTION come under the umbrella of the Department of Urban Services internal audit function.

5.2 The department develops and reviews policy and legislation for municipal services, land use planning and environmental impacts, transport, housing energy and urban water infrastructure. The department also delivers services including parking, horticultural cleaning, forests, cemeteries, libraries, shopfronts and wildlife monitoring. The department ensures compliance with standards for building licensing, land development, construction and environment protection.

5.3 The total annual operating expenditure for the department as reported in the financial statements in 2000 was \$476m.

5.4 The internal audit function in the Department of Urban Services is fully out-sourced. A panel of three contractors provide internal audit services to the department. The department's Corporate Finance section administers the contractors.

THE INTERNAL AUDIT FRAMEWORK

5.5 The Audit compared the Department's framework, as it existed during the initial stages of the audit, with the audit identified better practices. Significant issues noted in the comparison follow.

Audit Committee

5.6 *Existence* – The department has an Audit Committee.

5.7 *Audit Committee Membership* – The department's audit committee is chaired by the Chief Executive.

5.8 There are six internal members (i.e. departmental employees), and one external member. The external member is not an ACT Public Servant. The internal members all manage significant departmental activities.

5.9 *Procedures etc* – The audit committee’s meeting procedures and protocols are better practice. The committee meets frequently, comprehensive minutes are recorded, internal audit reports are delivered to the committee and the committee is briefed by internal audit contractors on the outcomes of audits. The committee approves audit plans and is provided with comprehensive reports on audit progress.

5.10 *Audit Committee Charter* – The department has a formally endorsed document titled ‘Audit Committee Operating Framework’. The document, although comprehensive, does not include all the better practice components of an audit committee charter. For example, the committee is not given unlimited access to departmental information sources.

Audit Comment

5.11 With the exception of membership and chairpersonship of the audit committee and some refinements to the audit committee charter the department has an audit committee which generally incorporates better practice principles.

5.12 In relation to audit committee membership the principle is that audit committee members should not have the potential to influence audit activity over areas they manage. With departmental managers on the committee this potential exists. As currently constituted the audit committee has members who manage areas which would be expected to be the subject of internal audits. In addition, as currently constituted, the committee is unlikely to be perceived as independent or impartial.

5.13 The audit committee’s independence would be enhanced by having a chairperson who is not an employee of the department.

Internal Audit

5.14 *Existence* – The department has an internal audit function.

5.15 *Resources* – The department bases its long-term strategic audit program on a formal risk assessment. This is better practice in determining the adequacy of audit coverage.

5.16 The department’s expenditure on internal audit is within the mid range of expenditures by Territory agencies. Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1* of this report.

5.17 *Reporting Line* – The Director of Corporate Finance’s duties include being the contract manager for the internal audit function.

5.18 The Audit notes that over time it will be necessary for the Corporate Finance area to be reviewed by the internal audit function. A potential conflict may arise if the internal audit function is controlled by the auditee – in this case Corporate Finance. It is unsound practice for the Corporate Finance area to manage internal audit contractors unless there are compensating mechanisms in place.

5.19 The Chief Executive advised during the conduct of the audit that draft and final reports are presented directly to the audit committee and not through the Director of Corporate Finance. The Chief Executive also advised that the audit committee accepts or rejects proposed audits not the Director of Corporate Finance. The Audit acknowledges that the procedures advised by the Chief Executive should be an effective compensating mechanism to address the issue raised in the previous paragraph.

5.20 *Planning and Monitoring* – The department conducts surveys of auditees as part of its formal quality assurance procedures. The surveys are intended to gauge the effectiveness of internal audit activities. The Department also has a benchmark arrangement enabling comparisons to be made between the performances of its contracted internal auditors.

5.21 *Reporting and Implementation* – Better practices for reporting and implementation conducive to an effective internal audit function are in place.

5.22 The department’s procedures for the preparation and circulation of internal audit reports are effective.

5.23 Consultants are required to conduct follow up audits to assess the implementation of actions to address audit findings. Formal procedures for the implementation of actions to address audit findings are also in place.

5.24 *Internal Audit Charter* – The Department does not have a formally endorsed internal audit charter. The department has an internal audit protocol statement. This statement is attached to the Audit Committee Operating Framework document referred to in *paragraph 5.10* and is also attached to contracts made with the providers of internal audit services. The Audit Committee Operating Framework document

and the internal audit protocol statement contain most, but not all, the better practices important to the internal auditing function.

5.25 The department's internal audit protocol provides that draft reports and final reports containing audit findings are to be presented to the audit committee through the contract manager. The actual report presentation practice (see *paragraph 5.21*) is different to the procedure described in the protocol. The protocol should be revised to reflect the actual practice.

SUMMARY

5.26 The Department's internal audit function incorporates a range of better practices. The Audit view is that the Department's framework for managing internal audit is generally sound, however, there is an important area to be addressed.

5.27 The main issue identified to be addressed to improve the framework was:

- (a) the department's audit committee is chaired by the chief executive and has a majority of employee members directly involved in the department's management. The framework would be significantly strengthened if the proportion of external members on the committee was increased and an external committee member was the chair.

5.28 The following important documentation needed to be improved.

- (a) The terms in the contracts and the protocol document should be incorporated in a single document to form an internal audit charter.
- (a) The protocol document should be reviewed to ensure it reflects actual practice.
- (c) The Audit Committee Operating Framework document should incorporate other better practices in relation to the audit committee.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE

5.29 The views of the chief executive were sought as to how much assistance he considered was provided by the internal audit function.

5.30 The chief executive was satisfied with the assistance provided by the department's internal audit function and the tangible benefits it provides.

Audit Comment

5.31 The views expressed by the chief executive indicate that the framework for the function is sufficient in his opinion to effectively assist governance of the agency.

5.32 The Audit's detailed assessments of the internal audit framework overall provided a general confirmation of the views expressed by the chief executive.

DEPARTMENTAL RESPONSE

5.33 In a response dated 24 May 2002 to a draft of this Report, the department advised as follows.

The department has advised of its alternative view in relation to the issue of audit committee membership. In line with recommendations from the Australian National Audit Office, the department believes it is appropriate that public sector organisations take a different approach from the private sector when determining the membership of audit committees. Considering the governance model under which the department operates, based on individual accountability in the Chief Executive, the current format of the Urban Services audit committee is considered effective by the department in assisting the Chief Executive to meet these responsibilities.

The department will examine the feasibility of including relevant terms from contracts in the department's internal audit protocols. [see paragraph 5.28(a)]

Audit Comment on the Department's Response

5.34 The department did not agree with the Audit's view that the audit committee's framework would be improved if the proportion of external members on the committee was increased and an external committee member was the chair (see *paragraph 5.27(a)*).

5.35 The department believes it is appropriate that public sector organisations take a different approach from the private sector when determining the membership of audit committees and that this approach is in line with recommendations from the Australian National Audit

Office. The Audit's views in relation to the importance of independent membership of departmental audit committees and the ANAO comments are expressed in *Chapter 1*.

5.36 Specifically the chief executive has mentioned that the governance model under which the department operates is based on individual accountability of the chief executive. In *Chapter 3* the Audit explains that Ministers, as well as chief executives, have governance responsibilities for departments. Ministers' governance responsibilities include responsibilities for departmental financial and other performance.

5.37 The governance and accountability model for Territorial departments is not confined to chief executives as the Urban Services chief executive states, Ministers are also accountable. For most departmental operational matters Chief executives are accountable to Ministers with the Ministers being accountable to the public. The Territory's departmental governance and accountability structure will be strengthened by audit committees having a degree of independence from chief executives and reporting directly to Ministers as well as to chief executives.

6. DEPARTMENT OF EDUCATION AND COMMUNITY SERVICES

INTRODUCTION

6.1 This Chapter presents the results of an audit of the framework for internal auditing in the Department of Education and Community Services.

6.2 The department provides government school education, registration of non-government schools, coordination and purchase of vocational education and training, registration of childcare providers and provision of preschool education, and care and protection strategies for children. Expenditure for the department totalled \$661m in 2000.

6.3 The department has maintained an Internal Audit Unit, staffed by two departmental officers, since the mid-1980s.

THE INTERNAL AUDIT FRAMEWORK

6.4 The Audit compared the department's framework as it existed during the early stages of the audit with audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

6.5 *Existence* – The department has an audit committee.

6.6 *Audit Committee Membership* – All members of the audit committee are departmental employees who manage significant departmental activities. The department's chief executive is the chair of the audit committee.

6.7 *Audit Committee Charter* – The department has no separate audit committee charter, however, the audit committee membership and objectives are contained in the department's internal audit charter. References made to the audit committee in the internal audit charter omit some important better practices for an audit committee. For example, a requirement has not been included for the chairperson to sign the meeting minutes of the committee or the power for the committee to obtain advice from external parties.

Audit Comment

6.8 In relation to the audit committee membership, an important principle is that audit committee members should not have the potential to influence audit activity over areas that they manage. With departmental managers on the committee this potential exists. As currently constituted the committee is comprised of members who manage areas which would be expected to be the subject of internal audits. In addition, as currently constituted, the committee is unlikely to be perceived as independent or impartial.

6.9 The audit committee's independence would be enhanced by having a chairperson who is not involved in the management processes of the agency.

6.10 The department's documentation would be improved by a separate audit committee charter.

Internal Audit

6.11 *Existence* – The department has an internal audit.

6.12 *Resources* – The department's expenditure on internal audit is in the lower range of expenditures on internal audit by Territory agencies. Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1* of this Report.

6.13 *Reporting Line* – The department's organisational chart shows that the Chief Internal Auditor reports to the department's Executive Director of Vocational Education and Training and Corporate Services. The Chief Executive, however, advised during the conduct of the audit that the organisational chart reviewed by the Audit is inaccurate. The actual reporting is that the contracted internal auditor reports directly to the Chief Executive. The Department's Internal Audit Charter states that the Chief Internal auditor shall report the results of all internal audit reviews to the Chief Executive and to the members of the Audit Committee for their consideration.

6.14 *Planning and Monitoring* – The department has not conducted a formal process to identify the significant risks to the agency. A long-term audit plan aligned to the agency's major purposes and significant risks has not been prepared.

6.15 The internal audit function, however, conducts risk assessments and results of the risk assessments are linked to short-term audit plans. Audits have been completed on time to the schedule of the annual plan. The perspective of line managers is sought as part of the internal audit function's assessment of risk. This approach while useful does not represent the better practice of a plan aligned to the agency's long-term strategy referred to in *Chapter 2*.

6.16 There was no evidence of accepted quality assurance procedures being carried out to gauge the effectiveness of the department's internal audit function.

6.17 *Internal Audit Charter* – The department has a formal and endorsed internal audit charter dated 1995. Minor revisions made to the charter in 1998 and 2001 have not been formally endorsed by the Chief Executive or audit committee.

6.18 *Reporting and Implementation* – For the period 1998 to 2001 the Department had a formal and endorsed procedure for actions to be taken to address findings made in audit reports.

6.19 Procedures for the presentation and distribution of audit reports are formalised and endorsed in the department's audit manual.

SUMMARY

6.20 The Audit view is that the Department's framework for managing internal audit needs to be strengthened.

6.21 The main issues identified to be addressed were:

- (a) the department should reassess the resources being applied to internal audit for their adequacy;
- (b) all members of the audit committee including the chair are departmental managers. The department's internal audit framework would be significantly improved if the audit committee had external members and the chair was one of these external members; and
- (c) quality assurance procedures to gauge the effectiveness of internal audit activities should be designed and implemented.

6.22 The following important documentation needs to be developed or improved.

- (a) The department has no separate audit committee charter. Reference made to the audit committee in the department's internal audit charter should include additional aspects of better practice for an audit committee.
- (b) No long-term audit plans have been prepared for the internal audit function.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE

6.23 The views of the Chief Executive were sought as to how much assistance she considered was provided to her by the function.

6.24 The Chief Executive was satisfied with the assistance which internal audit provided.

Audit Comment

6.25 The comments provided by the Chief Executive indicate that, in her view, the function was sufficient to make an effective contribution to good governance of the department.

6.26 The audit's view was that the absence of several important better practices limited the contribution to departmental governance which the internal audit function can provide.

DEPARTMENTAL RESPONSE

6.27 In response dated 29 May 2002, to drafts of this Report the department advised of a number of initiatives to improve their internal audit framework as follows.

The Department recognises that there is a need to review the current membership of its Internal Audit Committee. To this end the Committee will now be limited to 5 individuals two of whom will be external to the department [see paragraph 6.21 (b)]

The department agrees and intends that one of the external members be appointed as chair of the Committee [see paragraph 6.21 (b)]

The Department has developed a new Internal Audit Committee Charter that will be endorsed by the Chief Executive prior to the next Internal Audit Committee meeting. In addition to this the Internal Audit Charter has been reviewed and updated in line with best practice [see paragraph 6.22 (a)]

As part of its revised internal audit function, the Department intends to establish a panel of internal audit firms on which it can rely to provide specialist internal audit reviews within key areas of the organisation, in order to increase the activity of the internal audit function and its presence [see paragraph 6.21 (a)]

Under the new internal audit arrangements that have been established a comprehensive risk management assessment will be undertaken as an early priority. This will then be used to assist in setting long term internal audit program strategies and priorities, conducted in line with Audit's better practice guide [see paragraph 6.22 (b)]

The Department proposes to undertake a comprehensive risk management assessment as a matter of priority.

New quality assurance processes will be established as part of the changes being introduced for the updated internal audit functions. The concepts of quality assurance for internal audit have already been introduced in the revised Internal Audit Charter [see paragraph 6.21 (c)]

The Department has developed a new Internal Audit Committee Charter that will be endorsed by the Chief Executive prior to the next Internal Audit Committee meeting. In addition to this the Internal Audit Charter has been reviewed and updated in line with best practice and will be endorsed by the new Committee when it next meets [see paragraph 6.22(a)]

Whilst the Department has been generally satisfied with the function of internal audit it is clear that in line with better practice that there are a number of improvements which can be made as outlined above.

These improvements include such things as the establishment of an Internal Audit Committee Charter; revision of the existing Internal Audit Charter; seeking the appointment of an independent Member and Chair; reducing the size of the Committee; undertaking a risk management assessment and using more external audit resources for particular audits.

Audit Comment on the Department's Response

6.28 The Audit welcomes the department's positive response and its proposals and actions to improve its internal audit framework.

7. DEPARTMENT OF HEALTH AND COMMUNITY CARE

INTRODUCTION

7.1 This Chapter presents the results of the audit of the framework for internal auditing in the ACT Department of Health and Community Care.

7.2 The department aims to lead in maximising both community and individual health and well being. The department seeks to achieve this by providing direction, leadership, and by harnessing resources across the health and community care system.

7.3 The department's total expenditure for 2000 was \$484m consisting of \$384m for the department and \$100m Territorial. Of the department's expenditure some \$311m is paid to other ACT government agencies which have their own internal audit functions.

7.4 The internal audit function in the department is fully out-sourced. The internal audit function has been established for several years.

THE INTERNAL AUDIT FRAMEWORK

7.5 The Audit compared the department's framework, as it existed during the early stages of the audit, with the audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

7.6 *Existence* – The department has an audit committee.

7.7 *Audit Committee Membership* – The audit committee is chaired by the Chief Executive.

7.8 The audit committee has four members all of whom are departmental managers.

7.9 *Audit Committee Charter* – The Department has no formal audit committee charter. A terms of reference for the audit committee was written and approved in 1995 and last reviewed in 1998. The terms of reference are outdated and do not include many of the elements which would be expected in a better practice audit committee charter.

Audit Comment

7.10 Better practices have not been adopted in relation to the charter and membership of the audit committee.

7.11 The internal audit function's role in relation to governance processes would be more effective if an independent audit committee existed.

7.12 In relation to audit committee membership an important principle is that audit committee members should not have the potential to influence audit activity over areas they manage. With departmental managers on the committee this potential exists. As currently constituted the audit committee has members who manage areas which would be expected to be the subject of internal audits. In addition, as currently constituted, the committee is unlikely to be perceived as independent or impartial.

Internal Audit

7.13 *Existence* – The department has an internal audit function.

7.14 *Resources* – Since June 1998, only four internal audits have been undertaken.

7.15 The department's expenditure on internal auditing is in the lower range of expenditures by Territory agencies. Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1*.

7.16 *Reporting Line* – The Financial Management Unit which reports to the Financial Management and Support Services Section manages contracted internal audit services.

7.17 The Audit notes that over time it will be necessary for the Financial Management and Support Services area to be reviewed by the internal audit function. A potential conflict may arise as the internal audit function is managed by the Financial Management and Support Services area. It is unsound practice for the Financial Management and Support Services area to manage internal audit contractors auditing that area unless there are compensating mechanisms in place.

7.18 Mechanisms for the audit committee to monitor internal audit activities have not been formalised in an audit committee charter. There

therefore seems to be no compensating mechanisms in place for the issue mentioned in the previous paragraph.

7.19 *Planning and Monitoring* – In May 2001, the Department engaged an accounting firm to draft its long-term audit plan to cover a three-year period to 2004. At the completion of this audit, the long-term audit plan had not been approved and implementation of the plan had not commenced.

7.20 The department's long-term audit plan for 1997-2000 was provided to Audit. Based on the documentation provided by the Department, it is not evident whether the long-term audit plan for that period was completely implemented and whether a detailed report as to the status or progress of planned audits was prepared.

7.21 Neither the department nor the contract internal auditors have conducted quality assurance procedures to gauge the effectiveness of the department's internal audit function.

7.22 *Internal Audit Charter* – The Department does not have a formal and endorsed internal audit charter.

7.23 *Reporting and Implementation* – There are no formal endorsed procedures for the presentation, distribution of audit reports or follow-up and implementation of agreed actions to address findings made in audit reports.

SUMMARY

7.24 The Audit view is that the framework for managing the internal audit needs to be significantly strengthened.

7.25 The main issues identified to be addressed were:

- (a) the department's internal audit activity has been minor;
- (b) the information reviewed for internal audit expenditure indicates that it would be useful for the department to reassess the resources being applied to internal audit for their adequacy; and
- (c) all members of the audit committee including the chair are senior agency employees who are directly involved in the department's management. The department's internal audit framework would be improved if the audit committee had external members and the chair was one of the external members.

7.26 The following important documentation needs to be developed or improved.

- (a) The department has no audit committee charter. The department's terms of reference for the audit committee are outdated and inadequate.
- (b) The department had no formal and endorsed procedures for the presentation and distribution of audit reports or the implementation of actions to be taken to address report findings.
- (c) There was no evidence of accepted quality assurance procedures including surveying to gauge the effectiveness of internal audit activities being carried out.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE

7.27 The views of the Chief Executive were sought as to how much assistance they considered was provided to them by the function.

7.28 The current Chief Executive of the Department of Health and Community Care was not satisfied with the standard of performance of the department's internal audit function. The Chief Executive noted that the department has not been as active as it could have been in recent years in relation to internal audit responsibilities. She stated her comment was in relation to the overall time period covered by the Audit. The first half of the period was prior to the chief executive taking charge of the department.

7.29 The chief executive further stated while the improvements that have occurred over the past two years in relation to updating the audit plan, meetings of the audit committee and the frequency of internal audits may not have happened as quickly as may have been optimal, they do in the chief executive's view, represent a marked improvement, over time, from the previous situation.

Audit Comment

7.30 The views expressed by the Chief Executive indicate that, in her view, the function has been insufficient to make an effective contribution to the good governance of the department.

7.31 The audit's view is that the absence of several important better practices significantly limited the contribution to departmental governance, which the internal audit function should provide.

DEPARTMENTAL RESPONSE

7.32 In a response dated 12 April 2002 to a draft of this Report, the department's Chief Executive advised.

I note the overall conclusion that the framework for the internal audit function for this Department should be significantly strengthened.

You have identified as weaknesses the lack of a formal and endorsed internal audit charter and the lack of formal and endorsed procedures for the presentation and distribution of audit reports and implementation of action to address the findings of audit reports.

I intend to have an internal audit charter in place and the associated processes formalised shortly, although I believe that there are formalised processes in place for the management of audits including ongoing monitoring to ensure the findings are actioned [see paragraph 7.26 (a) and (b)]

The Department's audit plan to cover the three-year period to 2004, which was still being formulated during the audit, has been completed and its implementation has commenced.

In a further response the chief executive advised:

In relation to membership of the audit committee, on further consideration, I do accept that external membership of the committee has merit and advise that the Department will seek appropriate non-departmental members to join the committee including the chairperson [see paragraph 7.25 (c)]

Audit Comments on Chief Executive's Response

7.33 The Chief Executive's response included proposals and actions to improve its internal audit framework. The response did not specifically commit the department to taking specific actions to address the issues identified in *paragraphs 7.25 (a) and (b) and 7.26 (b) and (c)*. The Audit view is that these issues should be addressed.

8. DEPARTMENT OF JUSTICE AND COMMUNITY SAFETY

INTRODUCTION

8.1 This Chapter presents the results of the audit of the framework for internal auditing in the Department of Justice and Community Safety.

8.2 The Department of Justice and Community Safety provides services to support the administration of justice, the protection of human rights, and legal services to government. The department also provides emergency prevention and response, community policing, registration of births, deaths and marriages, regulation and licensing of commercial arrangements, administration of the rental bonds scheme and the conduct of elections.

8.3 The total annual expenditure for the department including that for territorial in 2000 was \$193m.

8.4 An employee of the department performed internal audits for approximately one year ending June 2001. The department currently has no active internal audit function.

THE FRAMEWORK FOR THE FUNCTION

8.5 The Audit compared the department's framework as it existed in the early stages of the audit with audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

8.6 *Existence* – The department did not have an operating Audit Committee when the audit commenced.

8.7 *Audit Committee Membership* – All persons who attended a sole committee meeting held in June 2001 were employees of the department. All had significant management responsibilities.

8.8 The chair of the internal audit committee was the Chief Executive.

8.9 Draft documents available to the audit at the time of the audit's completion indicate that it is the intention of the department to formalise

that the members of the internal audit committee will be internal to the department.

8.10 *Audit Committee Meetings* – Only one meeting of the committee was held in 2001 and no meetings were held in 1999 and 2000.

8.11 *Audit Committee Charter* – At the time this audit was completed the department had no endorsed audit committee charter.

Audit Comment

8.12 In relation to audit committee membership an important principle is that audit committee members should not have the potential to influence audit activity over areas they manage. With departmental managers on the committee this potential exists. As currently constituted most audit committee members manage areas which would be expected to be the subject of internal audits. In addition, as currently constituted, the committee is unlikely to be perceived as independent or impartial.

Internal Audit

8.13 *Existence* – The department has no active internal audit function.

8.14 *Resources* – The department had an in-house internal auditor for the 12 months ending June 2001. Following unsuccessful efforts to engage a full time person to the position the department remained undecided as to how to resource the function at the time the audit was completed. Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1*.

8.15 *Internal Audit Charter* – At completion of this audit the department had no endorsed internal audit charter.

8.16 A draft charter (based on a version prepared in 1995 when an internal audit charter was first considered by the then Attorney General's Department) was provided to, but not endorsed, at the June 2001 internal audit committee meeting.

8.17 *Planning and Monitoring* – The department has a long-term (three year) audit plan. The plan, however, only identifies a small number of topics to be audited.

8.18 The department has not conducted any formal assessment of the risks to the department and therefore has not based the audit plan on the results of such an assessment.

8.19 *Reporting and Implementation* – Procedures for the reporting of audit findings and the implementation of actions to address audit findings had not been formalised or endorsed at the completion of this audit.

SUMMARY

8.20 Some efforts have been made to commence an internal audit function within the department. A temporary internal auditor was engaged to conduct internal audits for a period and efforts have been made to engage a full time auditor to continue in the audit role.

8.21 At the completion of the audit, however, the department did not have a formally endorsed framework in place for the operation of an internal audit function or resources engaged to progress the department's audit program.

8.22 As a result the Audit considered that the framework for managing internal audit needed to be significantly strengthened.

8.23 The main issues identified for addressing were:

- (a) all members of the audit committee including the chair are internal to the agency and directly involved in the department's management. The department's internal audit framework would be improved if the audit committee had external members and the chair was one of the external members;
- (b) the audit committee has not operated other than for one meeting in 2001; and
- (c) the department has no currently operating internal audit function.

8.24 Important documentation needs to be developed or improved in the following areas:

- (a) plans for internal audits cover a limited number of topics;
- (b) the department has no endorsed audit committee charter;
- (c) the department has no endorsed internal audit charter;

- (d) the department has no formal and endorsed procedures for actions to be taken to address internal audit report findings; and
- (e) reporting formats and quality assurance procedures have not been developed.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE

8.25 The views of the Chief Executive were sought as to how much assistance they considered was provided to them by the internal audit function.

8.26 The Chief Executive of the Department of Justice and Community Safety recognised that the function had not received sufficient attention in the past.

Audit Comment

8.27 The comments by the Chief Executive indicate his view that the internal audit function was previously insufficient.

8.28 The audit's assessments of the internal audit framework provide confirmation of the view expressed by the Chief Executive.

DEPARTMENTAL RESPONSE

8.29 In responses to drafts of this Report the department's Chief Executive stated the following.

I have been aware for some time for the need to give greater priority to corporate and governance issues across the department. To this end I sought and obtained approval late last year for the creation of a senior executive position of Executive Director, Corporate Services. This position has now been established and an appointment has been made recently.

This position will provide strategic direction, planning, management and co-ordination of the Department's corporate areas and services, particularly finance, human resources, industrial relations, internal audit, information technology and accommodation, to ensure those areas and services effectively and efficiently support departmental business activities and functions.

One of the highest priorities is to finalise the implementation of new internal audit arrangements across the department [see paragraph 8.23(c)]

The Internal Audit Committee has now been reformed and its charter is being revised [see paragraph 8.24(b)]

Two significant reviews in the nature of internal audits have been undertaken recently: a review of the financial management systems and arrangements at the ACT Courts Administration (final report now received and recommendations under consideration), and a review of the budget base and finances of the Emergency Service Bureau (to be completed in early June) [see paragraph 8.23(c)]

Both these reviews have been undertaken by consultants while the Department is assessing its internal audit needs.

A number of other audits and reviews have been programmed.

Audit Comment on Department's Response

8.30 The chief executive's responses provided a general undertaking to improve the department's internal auditing framework and also advised of steps taken in this regard. The department's implementation of actions to strengthen its internal auditing framework should incorporate the full range of better practices listed in *Chapter 2* of this Report. The Department should specifically address the issues identified in *paragraphs 8.23(a) and (b) and 8.24(a), (c), (d) and (e)*. The Audit welcomes the department's positive responses.

9. CANBERRA INSTITUTE OF TECHNOLOGY

INTRODUCTION

9.1 This Chapter presents the results of the audit of the framework for internal auditing in the Canberra Institute of Technology. The results of the Audit's assessment of the Institute's framework is reported in this section of the Report because of the similarity of the Institute's governance arrangements with that of the Territory's departments.

9.2 The Canberra Institute of Technology is responsible for training the workforce with skills appropriate to the current and forecast needs of industry with enhanced career prospects and quality of life.

9.3 The annual expenditure of the Institute in 2000 was \$69m.

9.4 Internal audit has been out-sourced since the Institute's formation in 1988.

THE FRAMEWORK FOR THE FUNCTION

9.5 The Audit compared the department's framework, as it existed in the early stages of the audit, with Audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

9.6 *Existence* – The institute has a Resources Board. The Board deals with a wide range of issues including internal audit matters. The Institute does not have an audit committee.

9.7 *Membership* – As stated the Institute has no separate audit committee. A ten member Resources Board is responsible for some of the duties of an audit committee.

9.8 There is provision for four members who are not Institute employees. Three members are appointed from the Director's Advisory Council⁹ including the chair. One member is a representative of the CIT Students' Association.

⁹ The Director's Advisory Council is established by section 28 of the Canberra Institute of Technology Act 1987.

9.9 There are six members who are employees of the Institute. Two of these are elected staff representatives. The other four members are senior Institute employees directly involved in managing the institute's activities.

9.10 *Audit Committee Charter* – The Institute has no audit committee charter. The Resources Board has a terms of reference which makes limited mention of the boards audit committee responsibilities.

Audit Comment

9.11 Better practice has not been adopted in relation to the formation of a separate audit committee with an audit committee charter. The Resources Board is not an effective substitute for an audit committee.

9.12 In relation to audit committee membership an important principle is that committee members should not have the potential to influence audit activity over areas they manage. The Institute should create an audit committee separate from the Resources Board without members who are employees of the Institute.

Internal Audit

9.13 *Existence* – The Institute has an internal audit function.

9.14 *Resources* – Documentation for the tender process for internal audit services, confirmed that audit resources had been obtained as part of a competitive tender process.

9.15 The Institute's expenditure on internal audit is within the mid range of expenditures on internal audit by Territory agencies. Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1*.

9.16 *Reporting Line* – The Finance Unit, which is part of the Corporate Services Division, is responsible for managing contracted internal audit services.

9.17 The Audit notes that over time it will be necessary for the Corporate Services area to be reviewed by the internal audit function. A potential conflict may arise if the internal audit function is controlled by the auditee – in this case Corporate Services. It is unsound practice for the Finance Unit and Corporate Services area to manage internal audit contractors unless there are compensating mechanisms in place when the

contractors are conducting audits of Corporate Services activities. Compensating mechanisms are not currently in place.

9.18 *Planning and Monitoring* – The Institute has not conducted a formal process since 1997 to identify all its significant risks. A long-term audit plan aligned to the agency’s major purposes and all significant risks has also not been prepared.

9.19 The agency has prepared a Fraud Risk Assessment. This type of document is appropriately focussed on fraud risks. It does not, however, constitute a complete assessment of all the potential significant risks to the Institute.

9.20 An annual audit plan is prepared and audits have been completed on time to the schedule of this plan. The Institute have advised that the plan is developed through informal widespread consultation. This approach is useful and sound but does not represent the complete better practice of a plan aligned to the agency’s long term strategy referred to in *Chapter 2*.

9.21 Neither the Institute, nor its contracted internal auditors conducted quality assurance procedures to gauge the effectiveness of the internal audit function.

9.22 *Internal Audit Charter* – The Institute does not have a formal and endorsed internal audit charter. Tender documentation was reviewed by the audit as a possible alternative for an internal audit charter but was found to contain only limited attributes of a formal charter.

9.23 *Reporting and Implementation* – The Institute had no formal endorsed procedure for ensuring the implementation of actions to address findings made in internal audit reports. The Audit was advised that the Resources Board gave consideration to introducing formal procedures in December 2001.

9.24 As there was no audit committee there are no formal endorsed procedures for the presentation and distribution of audit reports to an audit committee. The Institute has advised that the Director’s Advisory Council considers internal audit reports prior to their distribution.

SUMMARY

9.25 The Audit view is that the framework for managing internal audit needs to be significantly strengthened.

9.26 The main issues identified for addressing were:

- (a) the Institute has no designated audit committee;
- (b) there was no evidence of accepted quality assurance procedures being conducted to gauge the effectiveness of internal audit activities; and
- (c) reporting lines for internal audit did not include the provision of audit plans, audit findings and reports directly to an audit committee for their consideration.

9.27 Important documentation needed to be developed or improved in the following areas:

- (a) a formal endorsed audit committee charter;
- (b) a formal endorsed internal audit charter;
- (c) long term audit plans for the internal audit function;
- (d) formally endorsed procedures for the presentation of audit reports to an audit committee and distribution to stakeholders; and
- (e) formally endorsed procedures for the implementation of actions to address audit findings.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE

9.28 The views of the Chief Executive were sought as to how much assistance they considered was provided to them by the internal audit function.

9.29 The Chief Executive of the Canberra Institute of Technology was satisfied with the assistance which internal audit provided him.

Audit Comment

9.30 The comments provided by the Chief Executive indicate that, in his view, the function was sufficient to make an effective contribution to good governance of the Institute.

9.31 The Audit's view is that the absence of several important better practices limits the contribution to the Institute's governance, which the internal audit function can provide.

INSTITUTE RESPONSE

9.32 In a response dated 24 May 2002, to a draft of the Report, the Institute advised the following.

CIT agrees to strengthen its internal audit framework as recommended. This will include development or improvement of audit charters [see paragraph 9.27(a) and (b)], long term audit plans [see paragraph 9.27(c)] and formally endorsed procedures [see paragraphs 9.27(d) and (e)]. These improvements will take place as part of CIT's commitment to establish a standalone Audit Committee [see paragraph 9.26(a)] within CIT's governance structure.

Audit's Comment on the Institute's Response

9.33 The Audit welcomes the Institute's response including its positive commitment to strengthen its internal audit framework. Not specifically addressed in the Institute's response were the issues identified in *paragraphs 9.26(b) and (c)*. The issues should receive attention.

SECTION C

STATUTORY AUTHORITIES

This section of the Report includes an introductory chapter on internal auditing and statutory authority governance. The remaining chapters present the results of the audit of the internal auditing frameworks operating in the authorities listed below:

- ACT Health and Community Care Service;
- Kingston Foreshore Development Authority; and
- Public Trustee.

10. INTERNAL AUDIT AND STATUTORY AUTHORITY GOVERNANCE

INTRODUCTION

10.1 This Chapter briefly outlines the legislated governance arrangements for statutory authorities and the relationship of internal audit functions, including audit committees, to these arrangements.

LEGISLATED GOVERNANCE ARRANGEMENTS FOR STATUTORY AUTHORITIES

10.2 Section 54 of the *Financial Management Act 1996* provides that:

The chief executive officer of a Territory authority is responsible, under the responsible Minister, for the efficient and effective financial management of the authority.

10.3 Chief executive officers responsibilities as provided in the legislation include ensuring that adequate control is maintained over assets and liabilities of the department and the department's accounting systems.

10.4 The responsible Minister is defined by *the Financial Management Act 1996* as the Minister administering the Act by which the authority was established. The *Annual Reports (Government Agencies) Act 1995* provides that the responsible Minister is the Minister administering the Act which established the authority.

10.5 The administrative arrangements made by the Chief Minister under the *Australian Capital Territory (Self Government) Act 1988* and the *Public Sector Management Act 1994* identify the Minister allocated responsibility for respective statutory authorities.

10.6 Comments on the arrangements for some particular authorities follow.

Health and Community Care Services Board

10.7 The *Health and Community Care Services Act 1996* provides for the establishment of the board. The legislation provides for a chief executive, appointed by the Minister, with the agreement of the board, to perform the duties of the board. The legislation also provides that the

board shall perform its functions and exercise its powers in accordance with any directions given by the Minister.

Kingston Foreshore Development Authority

10.8 The *Kingston Foreshore Development Authority Act 1999* provides for the establishment of the authority. The legislation provides for the appointment of a chief executive officer, after consultation with the Minister. The chief executive officer is to manage the affairs of the authority in accordance with the general directions of the authority. The functions of the authority must be discharged in accordance with sound business practice.

10.9 The legislation also provides that the Minister may give directions to the authority in relation to the performance of its functions.

Public Trustee for the ACT

10.10 The *Public Trustee Act 1985 No 8* provides for the establishment of the office of Public Trustee. The legislation provides for the appointment of a chief executive. The chief executive is to perform the duties of the office.

10.11 The legislation provides for the trustee to have a board to control the investment of trust monies but not the overall performance of the agency. The legislation provides that the Minister may appoint external members to the board and that the chief executive is the chair of the board.

Audit Comment

10.12 According to legislation establishing the authorities the governance processes for the Health and Community Care Services Board and the Kingston Foreshore Development Authority are the responsibility of the board/authority. The chief executives for both agencies reports to the board/authority. It is noted that the establishing legislation provides that the chief executives are responsible to the board/authority while the Financial Management Act provides that the chief executive is responsible to the Minister.

10.13 The governance processes for the Public Trustee Office are the responsibility of the Public Trustee. There is a board but the board has no responsibility for the management of the Trustee's activities. Legal

advice to the Trustee indicates that this recognises the legal position of the Public Trustee who is accountable to the Supreme Court for the trust.

STATUTORY AUTHORITY GOVERNANCE AND INTERNAL AUDIT

10.14 The assistance that internal audit can provide to authorities, boards and chief executives is similar to the assistance which internal audit can provide to Ministers and departmental chief executives in relation to departmental governance. (see *Chapter 3*)

10.15 As chief executives and boards cannot always be directly involved in the detailed functions of their statutory authorities but remain responsible for the overall operations they must rely on internal controls, systems and delegated authority. Effective governance processes should enable the chief executive and the board to provide the directions necessary throughout the authority to achieve desired outcomes and obtain accurate and reliable feedback on the authority's performance.

10.16 Similarly as with departments, internal audit functions can provide assurance of the adequacy and effectiveness of an authority's governance processes. Some examples are provided in *Chapter 3*.

10.17 The internal audit function's role in relation to governance processes will be more effective if an independent audit committee exists. An audit committee's independence will be enhanced by having a chairperson who is not involved in the management decisions of the agency. The Audit Committee furnishing a report to the board on the results of internal audit activities for the year would assist the board in meeting its overarching governance responsibility. The Audit is also of the view that it would be sound practice if the Minister were provided with a report by the board of the internal audit's functions for the year. Chief executives would also benefit from the assurance that an internal audit function can provide that the boards' expectations are being met.

CONCLUSION

10.18 Under legislation chief executives, boards and Ministers have governance responsibilities for the operation of statutory authorities. As summarised in this Chapter internal audit functions and audit committees with appropriate membership and reporting lines can provide valuable assistance to chief executives, boards and Ministers.

11. ACT HEALTH AND COMMUNITY CARE SERVICE

INTRODUCTION

11.1 This Chapter presents the results of the audit of the framework for internal auditing in the ACT Health and Community Care Service (the Service).

11.2 The Canberra Hospital and ACT Community Care form the Service. The primary functions of the Service are to promote, protect and maintain the health of the residents of the Territory. The Service is also to provide health and community cares services to residents of the surrounding region, provide training and education in the provision of health and community services and to encourage research in these fields.

11.3 The total expenditure of the Canberra Hospital for 2000 was \$240m and for ACT Community Care \$77m.

11.4 The internal audit functions in both the Canberra Hospital and ACT Community Care are fully out-sourced. Both functions have been established for some years.

THE FRAMEWORK FOR THE FUNCTION

11.5 The Audit compared the Service's framework as it existed in the early stages of the audit with Audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

11.6 *Existence* – The Service has an audit committee. It is a joint committee of the Canberra Hospital and ACT Community Care.

11.7 *Audit Committee Membership* – The audit committee comprises three independent members. One of which is the chairperson. The chair of the audit committee was also the chair of the Board.

11.8 The Chief Executives of the Canberra Hospital and ACT Community Care and other executives and managers of the two entities attend audit committee meetings. Although they attend meetings the chief executives are not committee members.

11.9 *Audit Committee Charter* – The joint committee has a formal and endorsed charter. The charter, however, does not incorporate all better practices. For example, the charter requires only one board member to be present to form a quorum¹⁰ and the charter does not give the committee unhindered access to information and expert advice.

Audit Comment

11.10 Apart from some improvements to the audit committee charter the service has on the whole an audit committee that incorporates better practice principles. The independent membership and chair of the committee represents better practice.

Internal Audit

11.11 *Existence* – The Service has an internal audit function.

11.12 *Resources* – ACT Community Care’s expenditure on internal audit was within the lower range of expenditures on internal audit by Territory agencies for the three years 1998 to 2000. Increases in the expenditure on internal audit in 2000-2001 and 2001-2002 places the agencies’ expenditure on internal audit within the moderate range of expenditures for internal audit by Territory agencies.

11.13 The Canberra Hospital’s expenditure on internal audit is within the low range for Territory agencies.

11.14 Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1*.

11.15 *Planning and Monitoring* – Both entities are covered by a long-term audit plan. The audit review of the document suggested that the audit plan was prepared after conducting a business risk assessment, which gave consideration to management’s perspective.

11.16 Neither entity conducts formal quality assurance procedures to assess the effectiveness of the audit function. The Chief Executives have advised that the effectiveness of the audit function is discussed and assessed regularly by the audit committee. While this is a sound practice it does not constitute the formal quality assurance procedures referred to

¹⁰ A quorum is the fixed number of members that must be present to make the proceedings of the audit committee meeting valid. Specifying that sufficient members are present enables the expertise of board members to be applied to the evaluation of matters before the committee and assists with independent decision making.

in *Chapter 2*.

11.17 *Internal Audit Charter* – Both the Canberra Hospital and ACT Community Care have internal audit functions but both do not have internal audit charters as bases for these functions. Some of the better practice elements of an internal charter are included in contracts for the provision of internal audit services.

11.18 For ACT Community Care, some terms of reference for an internal audit function are contained in its Chief Executive's Financial Instructions. These terms, however, do not contain all necessary elements of better practice.

11.19 It is better practice for all the roles and responsibilities of the internal audit function to be included in a formal and endorsed charter which is regularly reviewed.

11.20 *Reporting and Implementation* – Both agencies have a requirement stated in their contracts that internal audit contractors will provide copies of the final report to the Audit Committee and management.

11.21 The agencies contracts require the maintenance of a schedule of the implementation of action to address internal audit findings. The contracts also require the Audit Committee to monitor audit reports until it is satisfied that all necessary action required has been completed.

11.22 ACT Community Care has an endorsed procedure in line with the requirement of its contracts for ensuring the implementation of action to address internal audit findings.

11.23 The schedule could be improved by incorporating targets and the names of officers responsible for implementation.

11.24 The Canberra Hospital did not have formally endorsed procedures in place in line with requirements in its contracts for ensuring the implementation of actions to address internal audit findings.

SUMMARY

11.25 The Service's internal audit function incorporates a range of better practices. The Audit view is that the Service's framework for managing internal audit is generally sound, however, there are some important areas to be addressed.

- (a) The charter for the audit committee requires only one independent to be present to form a quorum and does not include all better practices.
- (b) Neither the Canberra Hospital or ACT Community Care has a formally endorsed internal audit charter.
- (c) Formal quality assurance procedures are not conducted to gauge the effectiveness of either agency's internal audit functions.
- (d) It would be useful for The Canberra Hospital to reassess the level of resources being applied to internal audit for their adequacy.

ASSISTANCE TO THE CHIEF EXECUTIVE

11.26 The views of the Chief Executives were sought as to how much assistance they considered was provided to them by the function.

11.27 The Chief Executive of the Canberra Hospital advised in response to the report that he was generally satisfied with the performance of the internal audit function and of the processes and procedures supporting it. The Chief Executive, had previously stated the return on investment in its internal audit function has been reasonable based on the funds made available. The Chief Executive indicated that the board is currently reviewing the budget for internal audit.

11.28 The Chief Executive of ACT Community Care has been satisfied with the standard of performance of its internal audit function in recent years but also indicated that its internal audit program may be expanded.

Audit Comment

11.29 The Audit's detailed assessments of the internal audit framework overall provided a general confirmation of the views expressed by the chief executives.

AUTHORITY'S RESPONSE

11.30 In response to drafts of this Report the agencies advised of initiatives to improve their internal audit framework as follows.

- ACT Community Care intend to strengthen processes for the distribution of internal audit reports, consideration of recommendations and progress on implementations at monthly meetings of the Executive.

- The Canberra Hospital introduced formal procedures for ensuring the implementation of action to address internal audit findings in January 2002. The schedule would be improved by incorporating more specific detail on the implementation process and responsibilities for implementation.

The Chief Executive of the Hospital also advised of his alternative view in relation to the issue of reassessing the level of resources being applied to internal audit.

The Board has increased the level of funding for the internal audit function in the Hospital.

It may well be the that the possible high levels of funding for the Commonwealth agencies in Canberra could mean that the comparisons made is misleading. A more appropriate comparison could be made with a large peer hospital, say John Hunter Hospital in Newcastle, or with a regional area health service in NSW.

Audit Comment on the Authority's Response

11.31 The Audit welcomes the proposals and actions to improve the agencies' internal auditing frameworks. The Chief Executives' responses, however, did not identify actions to be taken to address the issues identified in *paragraphs 11.25 (a), (b) and (c)*. The Audit considers these issues should be addressed.

11.32 In relation to the Chief executive's response on reassessing the level of resources allocated to internal audit (see *paragraph 11.25 (d)*), as *Chapter 1* of this Report states, the comparison conducted by the audit was meant to be indicative. In the case of the Hospital, benchmark partners more suitable than Commonwealth agencies could certainly be identified. The point being made by the Audit is that the authority should conduct an assessment of the adequacy of its expenditure on internal auditing.

12. KINGSTON FORESHORE DEVELOPMENT AUTHORITY

INTRODUCTION

12.1 This Chapter presents the results of the audit of the framework for internal auditing in the Kingston Foreshore Development Authority.

12.2 The Kingston Foreshore Development Authority's main objective is to promote develop and manage the redevelopment and construction works of a 37 hectare site at Kingston. The redevelopment is to be staged over a ten year period. The authority was established as a statutory body in February 2000.

12.3 The authority has planned net assets of \$12-16m over the next three years.

12.4 An internal audit function for the authority is being introduced.

THE FRAMEWORK FOR THE FUNCTION

12.5 The Audit compared the authority's framework as it existed in the early stages of the audit with audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

12.6 *Existence* – The Authority has an Audit Committee.

12.7 *Audit Committee Membership* – The authority has an audit committee with two board members, one of which is the independent chairperson.

12.8 When the audit committee was formed in 2000 the Chief Executive was listed as a member of the committee in the audit committee charter. The chief executive position was vacant at this time. In 2001 a chief executive was appointed and recognised the potential conflict of responsibilities that being a member of the committee might present. The charter was amended to no longer provide that the chief executive would be a committee member.

12.9 *Audit Committee Charter* – The committee has a formal endorsed charter which incorporates better practices.

Audit Comment

12.10 Given its early stage of development the authority has a sufficient audit committee framework in place.

Internal Audit

12.11 *Planning and Monitoring* – At the time the audit was completed a formal assessment of risks to the authority (and consequently the Territory) had not been included in a long-term audit plan.

12.12 *Audit Activity* – The authority has appointed an internal auditor. At the time of the audit no internal audits had been completed.

12.13 *Internal Audit Charter* – The authority has a formal endorsed internal audit charter.

12.14 *Reporting and Implementation* – At the time this audit was completed the authority had not formalised procedures for the formats and circulation of reports and the implementation of actions to ensure that audit findings made in internal audit reports are addressed.

SUMMARY

12.15 The main issues identified by the Audit for addressing were:

- (a) minimal audit work has been performed to date; and
- (b) procedures are yet to be formalised and endorsed for the format and circulation of reports and to ensure that internal audit findings are effectively addressed.

AUTHORITY'S RESPONSE

12.16 In response to drafts of this report the authority advised of initiatives to develop their internal audit framework as follows:

- The authority completed a business risk assessment, fraud risk assessment and internal audit plan in March 2002.
- In March 2002 a timetable for internal audits was established with audits to commence in June 2002.

Audit's Comment on Authority's Response

12.17 The Audit welcomes the authority's response. The Authority is advanced in establishing a generally sound internal audit framework.

13. PUBLIC TRUSTEE

INTRODUCTION

13.1 This Chapter presents the results of the audit of the framework for internal auditing of the Public Trustee's operations.

13.2 The Public Trustee prepares wills, administers deceased estates, and manages funds held in trust. The Public Trustee held \$65m in trust in 2000. The Office has no internal audit function.

INTERNAL REVIEW

13.3 There is no independent committee that formally receives and reviews audit plans and reports or performs the other functions normally carried out by an audit committee. The Trustee has a Public Trustee Investment Board whose primary responsibility is to oversight the investment of trust funds but has none of the normal governance responsibilities of a board.

13.4 The Trustee has engaged consultants to conduct reviews of the Trustee's business practices and to develop strategic, business and marketing plans. The Public Trustee, however, has no independent internal assessment framework and currently does not have plans to introduce one.

Audit Comment

13.5 The Trustee has no internal review function independent of management to assess the effectiveness of the agency and its controls. There is no formal mechanism to report findings from internal reviews to an independent committee.

AUDIT CONCLUSION

13.6 For sound governance, given the large sums held in trust by the Public Trustee, an audit committee and internal audit function are warranted.

PUBLIC TRUSTEE RESPONSE

13.7 In a response to the final draft of this Report, the Public Trustee advised.

In relation to the comments, whilst I agree that we currently have no formal audit committees. I think it should be noted for a small agency having the responsibility for large sums of trust money we have taken independent advice and counsel to ensure that we do not breach our obligations as trustee. Working in a small agency that is off budget has its own difficulties in relation to available funds and the ability to utilise any funds for internal scrutiny purposes.

In this regard the Public trustee has prepared a paper in conjunction with the Board members, which looks at the corporate Governance requirements of a growing office and how any future Board or Committee should deal with the issues of risk management. In the meantime the office has established an Internal Investment Management Advisory Committee that meets regularly and provides its outcomes to the Public Trustee Investment Board. The Public Trustee has also developed a draft Risk Management Plan that the Board is reviewing for compliance with best practice. It is anticipated that this committee will be established in early July 2002.

Audit Comment on the Public Trustee's Response

13.8 The Audit understands the Trustee's response and appreciates the importance of the actions described in the response. The Audit however maintains its view that the Public Trustee should have a clearly designated audit committee and internal audit function.

SECTION D

ActewAGL JOINT VENTURE AND TERRITORY OWNED CORPORATIONS

This Section of the Report includes an introductory chapter on internal audit functions and governance of Territory Owned Corporations. The remaining chapters present the results of the audit of the internal audit frameworks in the following entities.

- ActewAGL Joint Venture;
- Totalcare Ltd; and
- ACTTAB Ltd.

14. TERRITORY OWNED CORPORATIONS GOVERNANCE AND INTERNAL AUDIT

14.1 This Chapter briefly outlines the legislated governance arrangements for Territory owned corporations and the relationship of internal audit functions, including audit committees, to these arrangements.

Territory Owned Corporations Act 1990

14.2 Territory owned corporations are listed in the *Territory Owned Corporations Act 1990* (the Act). The current Territory owned corporations are ACTEW Corporation Limited, ACTTAB Limited and Totalcare Industries Limited.

14.3 The Act provides for the principal objectives of Territory owned corporations to be to carry on business successfully, to operate at least as efficiently as any comparable business, and to maximise the sustainable return to the Territory.

14.4 The administrative arrangements made by the Chief Minister under the *Australian Capital Territory (Self-Government) Act 1988* identify the Portfolio Minister allocated responsibility for the respective Territory owned corporations.

14.5 The Act provides that two Ministers are eligible to hold voting shares in a Territory owned corporation on trust for the Territory. The voting Ministers after consulting with a Legislative Assembly committee appoint the directors of the corporation.

14.6 The Act provides that the corporation's directors shall submit to the voting Ministers a statement of corporate intent. The statement is to include the commercial objectives, business strategies and targets of the corporation. The Portfolio Minister is responsible for laying the statement of intent of the corporation before the Legislative Assembly.

14.7 The Act states that obligations set by the Act are in addition to the obligations imposed upon directors by any other law. The governance arrangements of private sector corporations are therefore applicable to Territory owned corporations. The governance of corporations under company law is the responsibility of a board of directors. The board is responsible for the corporation achieving its objectives. The chief

executive is generally responsible to the board for the operations of the corporation.

CORPORATE GOVERNANCE AND INTERNAL AUDIT

14.8 As with departments and statutory authorities the governance of corporations can be referred to as the processes by which the corporations are directed, controlled and held to account¹¹. These processes are the structures, systems and internal controls used to ensure that the corporations are performing efficiently and effectively as well as conforming to legislation and guidelines.

14.9 Similarly to departments and authorities internal audit functions can provide assurance of the adequacy and effectiveness of a corporation's governance processes. Examples are provided in *Chapter 3*.

14.10 As with departments and statutory authorities the internal audit function's role in relation to governance processes will be more effective if an independent audit committee exists. The audit committee's independence is usually achieved by forming the audit committee as a sub-committee of the board, which is made up of non-executive directors (i.e. directors not employed by the corporation to perform management duties).

14.11 Corporations' audit committees should prepare a report on the results of internal audit activities for the year. It would be of assistance if the voting shareholders (Ministers) were provided with this report. Chief executives would also benefit from the assurance that an internal audit function can provide that the boards' expectations are being met.

¹¹ ANAO Discussion Paper, Corporate Governance in Commonwealth Authorities and Companies, July, 1999.

15. ActewAGL JOINT VENTURE

INTRODUCTION

15.1 The Territory owned corporation, ACTEW Corporation Limited (ACTEW) and The Australian Gas Light Company (AGL) entered into a joint venture known as ActewAGL in October 2000.

15.2 The ACTEW internal audit had been long established. In October 2000 the function moved to ActewAGL along with the operations of ACTEW. The Audit focussed on the relocated internal audit with responsibility for the review of the relocated operations.

15.3 This Chapter presents the results of the audit of the framework for internal auditing for the ActewAGL Joint Venture (the joint venture).

15.4 The principal activities of the joint venture are to operate energy networks, water and sewerage services and supply energy and gas to customers. The joint venture's total expenditure was \$284m in 2001.

15.5 The performance of internal audits and reviews are predominantly out-sourced with an employee of ActewAGL closely managing and coordinating the function.

GOVERNANCE FRAMEWORK

15.6 The joint venture is organised as two partnerships, one distribution and one retail. The ActewAGL Joint Venture Board governs the business of the partnerships.

15.7 Three members of the board are nominated by ACTEW corporation and three members of the board are nominated by AGL. Members of the board must exercise their powers in the better interests of the partnership as a whole.

15.8 The board is assisted by three committees including an Audit and Risk Management Committee. The role of the Audit and Risk Management committee includes strengthening the independence of the audit function and internal control systems of the joint venture. The Audit Services Branch (the internal audit function) reports directly to the committee.

15.9 The Chief Executive Officer is responsible to the board for the business management of the partnerships. ActewAGL has six major

divisions headed by general managers who report to the Chief Executive Officer.

THE FRAMEWORK FOR THE FUNCTION

15.10 The audit compared the joint venture's framework, as it existed in the early stages of the audit, with audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

15.11 *Existence* – ActewAGL have an Audit and Risk Management Committee.

15.12 *Audit Committee Membership* – The ActewAGL Audit and Risk Management Committee has two members both external to the ActewAGL management team. One member is a non-executive member of the ACTEW Board and the other is the Chief Financial Officer of AGL, who is also the chairperson. The Chief Executive, Chief Finance Officer, Legal Counsel and Board Secretary and the head of internal audit normally attend meetings.

15.13 *Audit Committee Charter* – The Joint Venture has a formal endorsed audit committee charter for its Audit and Risk Management Committee. The charter has been regularly reviewed and represents better practice.

Audit Comment

15.14 ActewAGL have on the whole an audit committee that incorporates better practice principles. It would be preferable if the committee had more than two members. It is better practice to have between three and five members comprising an audit committee.

Internal Audit

15.15 *Existence* – ActewAGL have an internal audit function.

15.16 *Resources* – Consultants are engaged following the internal rules of the Joint Venture.

15.17 The department's expenditure on internal audit is in the upper range of Territory entities. The Joint Venture's expenditure is similar to that for fully private entities. Comments on the appropriateness of

expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1* of the Report.

15.18 *Reporting Line* – The head of the internal audit function has senior management status and direct access to the audit committee and the Chief Executive Officer of ActewAGL. Administratively, the head of internal audit reports to the Legal Counsel and Board Secretary of ActewAGL. The head, however, develops the plans for internal audit which are submitted to the audit committee for approval and makes the decisions for the engagement of consultants.

15.19 *Independence* – The charter specifies that the internal auditors should be independent of the activities they audit. The charter also declares internal audit independence by including a requirement that prohibits internal audit from assuming operating responsibilities.

15.20 *Planning and Monitoring* – The joint venture has a rolling long-term audit plan which considers key corporate risks. The plan also takes into account recent audit coverage, management input, and takes account of the corporate risk assessments done by the insurance and risk areas of the joint venture.

15.21 Monitoring of the progress and status of audits is adequately documented and presented to the audit committee.

15.22 The internal audit charter requires the head of internal audit to maintain mechanisms to evaluate the operations of audit services. The joint venture regularly conducts surveys to assess the effectiveness of the internal audit function. The internal audit function was benchmarked to the Global Audit Information Network (GAIN) in 2001.

15.23 *Internal Audit Charter* – The joint venture has a current endorsed and formal internal audit charter.

15.24 *Reporting and Implementation* – The joint venture has a standard format for audit reporting and a framework to ensure implementation of actions to address internal audit findings. The framework includes target dates and the manager responsible for the action. The internal audit charter states that the audit report is not finalised until management agreement to the implementation timetable for remedial action is obtained.

SUMMARY

15.25 The framework for the internal audit function includes a significant number of better practices. The Audit view is that the ActewAGL framework for managing internal audit is sound.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE OFFICER

15.26 The Chief Executive Officer's views were sought as to how much assistance he considered was provided by the internal audit function.

15.27 The Chief Executive Officer is very satisfied with the standard of performance of the internal audit function.

Audit Comment

15.28 The Audit's assessments of the internal audit framework provided confirmation of the views expressed by the Chief Executive Officer.

16. TOTALCARE LTD

INTRODUCTION

16.1 This Chapter presents the results of the audit of the framework for internal auditing in Totalcare Industries Limited (Totalcare).

16.2 Totalcare is a provider of integrated solutions and services in the areas of asset management and maintenance, professional and technical consulting, cleaning, decontamination and waste destruction services.

16.3 The total annual expenditure of the company in 2000 was \$84.7m.

THE FRAMEWORK FOR THE FUNCTION

16.4 The Audit compared the company's framework, as it existed in the early stages of the audit, with audit identified better practices. Significant issues identified in the comparison follow.

Audit Committee

16.5 *Existence* – The Company has a Finance and Audit Committee.

16.6 *Membership* – The Finance and Audit Committee has three members external to the corporation including the chairperson. The Chief Executive Officer and Chief Finance Officer attend committee meetings.

16.7 *Charter* – The Totalcare Finance and Audit Committee has the role to advise the board on all internal and external financial and audit matters. The Finance and Audit Committee had no current approved terms of reference or charter in relation to audit committee matters.

Audit Comment

16.8 The company has an audit committee and its independent membership committee represents better practice. Documentation of the committee's charter could be brought up to date.

Internal Audit

16.9 *Existence* – The Company has an internal audit function.

16.10 *Resources* – A new contract internal auditor was appointed in 2001. Totalcare's expenditure on internal audit is within the mid range

of expenditures on internal audit by Territory agencies. Comments on the appropriateness of expenditure on internal audit functions by Territory agencies in general are provided in *Chapter 1*.

16.11 *Reporting Line* – The Chief Financial Officer’s duties include the management of the internal audit function. The Audit notes that it will certainly be necessary for the finance area to be reviewed at some time by the internal audit function. As can be appreciated a potential conflict may arise for the Chief Financial Controller when the finance area is being audited. It is not better practice for the Chief Financial Officer to manage the internal audits of finance area unless there are compensating mechanisms in place.

16.12 *Planning and Monitoring* – Totalcare presented the Audit with a draft risk analysis and internal audit plan dated June 2001. During the conduct of the Audit the Chief Executive advised that the draft analysis and plan had been endorsed by the board.

16.13 The agency had no long-term audit plan. The draft internal audit plan provided covered a twelve month period. This approach is useful and sound but does not represent the complete better practice of a plan aligned to the agency’s long term strategy referred to in *Chapter 2*.

16.14 Totalcare does not conduct formal quality assurance procedures to assess the effectiveness of the audit function. The Chief Executive has advised that the effectiveness of the audit function is discussed and assessed regularly by the audit committee. While this is a sound practice it does not constitute the formal quality assurance procedures referred to in *Chapter 2*.

16.15 There was no evidence of formal quality assurance procedures being conducted to gauge the effectiveness of the internal audit functions.

16.16 *Internal Audit Charter* – At completion of the audit the company had no current formally endorsed internal audit charter.

16.17 *Reporting and Implementation* – There were no documented formally endorsed procedures for the presentation, distribution and implementation of actions to address internal audit findings.

SUMMARY

16.18 The Audit considered documentation of the company's framework for managing internal audit could be improved.

16.19 The main issues identified to be addressed to improve the framework were:

- (a) the Chief Financial Officer managed the internal audit function; and
- (b) formal quality assurance procedures are not undertaken to gauge the effectiveness of the company's internal audit function.

16.20 The main items of documentation identified for improvement were:

- (a) the company had no current formally endorsed audit committee charter;
- (b) the company had no current formally endorsed internal audit charter;
- (c) the company had no formally endorsed long-term internal audit plan; and
- (d) the company did not have formal endorsed procedures for the implementation of actions to address internal audit findings.

ASSISTANCE TO THE AGENCY AND CHIEF EXECUTIVE

16.21 The views of the Chief Executive were sought as to how much assistance he considered was provided to them by the internal audit function.

16.22 The Chief Executive Officer was satisfied with the standard of performance of the internal audit function.

Audit Comment

16.23 The comments provided by the Chief Executive indicate that, in his view, the function was sufficient to make an effective contribution to good governance of the company.

16.24 The Audit's view is that the internal audit function's contribution to the company's governance would have been limited to some extent by the absence of certain important better practices.

CORPORATION'S RESPONSE

In a response dated 28 May 2002, to a draft of this Report Totalcare advised.

Prior to, during and following the Auditor-General's review of Totalcare's internal audit function in May 2001 a number of changes were made to the operation of internal audit reflecting the changes and risks faced by the businesses and therefore the structure and focus of audit.

In March 2001, as approved by the Totalcare Board, the financial internal audit function of the company was outsourced to Walter & Turnbull, Chartered Accounting firm. At that time a risk assessment was carried out and a long-term and 12 month internal audit plan developed.

During the course of the year the internal auditors reported directly to the Board Audit & Finance Committee, which was made up of four Board members and also attended by the CEO and CFO of the company.

This Committee has now been discontinued by the Board in favour of a traditional Audit Committee. The Charter for this Committee and a revised Internal Audit Charter have been presented to the full Board of Totalcare with recommendations for minor changes. These Charters were put on hold whilst the Board considered and agreed the new structure of Board sub-committees but will now be formally endorsed by the Board in their meeting of Thursday 30 May 2002. [see paragraphs 16.20(a) and (b)]

The internal auditors will continue to report directly to the Audit Committee which will now be made up of two Board members and two independent members of the business community. The CEO and CFO will continue to attend the meetings as will both the internal and external auditors as required.

The new Committee will consider the next 12 month internal audit plan along with revision of the long-term plan. [see paragraph 16.20(c)] This will be considered in conjunction with the work being carried out by the company's Risk Manager who also conducts a number of internal audits in the company (many outsourced) and is currently conducting a company wide Risk Assessment.

The Committee will also consider documentation of the operational procedures of the function including quality assurance [see paragraph 16.19 (b)], reporting, action plans and monitoring.

Your final report will be submitted to the Audit Committee along with a proposed action plan for adopting all of those recommendations for practical application within Totalcare.

In an earlier response the chief executive advised:

- The contracted internal auditors will now report directly to the Chief Executive as internal audit manager. (see *paragraph 16.19(a)*)
- Procedures for the presentation, distribution and implementation of actions to address internal audit findings are to be adopted in written form by the Board. (see *paragraph 16.20(d)*)

Audit Comment on Corporation's Response

16.25 The Audit welcomes Totalcare's positive response and its proposed actions to improve its internal audit framework.

17. ACTTAB LTD

INTRODUCTION

17.1 This Chapter presents the results of the audit of the framework for internal auditing in ACTTAB.

17.2 ACTTAB provides a totaliser betting service, offering a wide range of betting facilities in active competition with other gambling mediums. The corporation had a gaming turnover of approximately \$118.5m in 2000 and \$139m in 2001.

17.3 The ACTTAB had no internal audit function at the commencement of the Audit.

INTERNAL REVIEW PROCEDURES

17.4 ACTTAB's board receives the report of the external audit of the annual financial statements and management letters associated with that audit.

17.5 ACTTAB between 1999 and 2001 conducted two reviews. Both related to the audit of the financial statements. As a result of these reviews instances were identified where ACTTAB's financial operations and internal controls could be improved.

17.6 Other than the reviews mentioned ACTTAB has not conducted internal planned, systematic, independent and objective assessments of the controls, legislative compliance, and efficiency of the agency.

17.7 At the time of the audit ACTTAB had not conducted any internal audits.

AUDIT CONCLUSION

17.8 For sound governance, given ACTTAB's large turnover an audit committee and an internal audit function are warranted.

CORPORATION'S RESPONSE

17.9 In a response dated 16 May 2002, to a draft of this Report ACTTAB advised of a number of initiatives including:

- *ACTTAB has appointed an audit committee comprising two non-executive Board directors. Hence, the Committee members are independent and have no management or consulting involvement with ACTTAB.*
- *The Chief Executive and General Manager, Finance and Strategic Planning General Manager participate as ex officio members providing information and support to the Committee, but have no decision-making powers.*
- *ACTTAB has appointed an internal auditor.*
- *The inaugural meeting of the Audit Committee was conducted on 9 May 2002. The Committee considered a draft Audit Committee Charter, principles to guide the internal audit function and the development of a three-year internal audit plan.*
- *The Audit Committee Charter will be approved by the ACTTAB Board at its meeting of 3 June 2002. The draft Charter satisfies all the better practices outlined in Chapter 2, Section 2.5 of the reviews report, except for the recommended Committee size of at least three members. The ACTTAB Board currently comprises 5 members, including an independent Chairman, three independent non-executive directors and one executive director, ACTTAB therefore elected to establish a relatively small Audit Committee that complied with the principles of independent membership. ACTTAB may review the size and membership of its Audit Committee in the future.*
- *The Audit Review Report has proven useful to ACTTAB, especially as ACTTAB is in the process of determining its audit framework. In particular, Chapter 2 entitled "Audit Approach" will prove very useful in benchmarking ACTTAB's Internal Audit function Charter and Internal Audit Plan currently under development, against a relevant better practice framework.*

Audit Comment on Corporation's Response

17.10 The Audit welcomes ACTTAB's positive response and its actions to introduce an internal audit framework.

Audit Committee Responsibilities¹²

Guidance issued by the Australian Accounting Research Foundation and International Federation of Accountants in respect to audit committees identifies that responsibilities of audit committees include the following important aspects.

- Reviewing the appropriateness and adequateness of the agency's accounting policies, financial statements and related information. This includes recommending whether the financial and non-financial statements should be signed.
- Reviewing compliance with laws, regulations and other external requirements, such as Australian Accounting Standards.
- Ensuring that effective risk management and internal control systems are in place and that macro risks to the agency are reported to the governing agency's authorities.
- Assessing the effectiveness of and compliance with the agency's code of conduct.
- Managing all aspects of the agency's relationship with the external auditor. This would include reviewing the scope of the audit, particularly identified risk areas.
- Oversighting the internal audit function, including the internal auditor's mission, charter and resourcing and approving and monitoring internal audit plans.
- Monitoring and critiquing management's responses to the findings of the agency's internal and external auditors.

¹² Auditor General's Report 3 of 2002 titled *Governance Arrangements of Selected Statutory Authorities* addresses statutory authority audit committees in some detail. (see *Chapter 9*)

Comparison of Resources Used on Internal Auditing

The Audit calculated a ratio, which expressed the expenditure on internal auditing¹³ by each Territory agency as a percentage of the agencies' total expenditure. Only the selected Territory agencies with an internal audit function were included in the comparisons. The expenditure on internal audit was considered for a three year period extending in the main from 1998. The Audit:

- ranked all selected Territory agencies according to this percentage; and
- ranked the percentages of Territory agencies with the percentages of Commonwealth agencies.

The first comparison showed expenditure on internal audit functions by Territory agencies varied widely with some agencies expending only minor amounts. The percentage of internal audit expenditure as a percentage of total expenditure for Territory agencies varied between .008% and .094%.^{14 15}

The second comparison showed that Territory agencies ranked in the bottom half of the combined results for Commonwealth and Territory agencies. This is because the percentage of internal audit expenditure as a percentage of total expenditure for Commonwealth agencies, which varied between .037% and .416%, was considerably higher.

¹³ The Audit used amounts specifically identified as expenditure on internal audits. It is acknowledged that agencies may spend additional sums on management reviews.

¹⁴ The highest result is for ActewAGL. This result is comparable to the median result for private sector agencies.

¹⁵ A budget increase for the joint audit function of the Chief Minister's Department in 2001-2002 will produce a significant increase in expenditure on internal auditing to a percentage of .175% of total expenditure.

PREVIOUS AUDIT REPORTS¹⁶

Reports Published in 1996

1. Legislative Assembly Members – Superannuation Payments/Members’ Staff – Allowances and Severance Payments
2. 1995 Taxi Plates Auction
3. VMO Contracts
4. Land Joint Ventures
5. Management of Former Sheep Dip Sites
6. Collection of Court Fines
7. Annual Management Report For Year Ended 30 June 1996
8. Australian International Hotel School
9. ACT Cultural Development Funding Program
10. Implementation of 1994 Housing Review
11. Financial Audits with Years Ending to 30 June 1996

Reports Published in 1997

1. Contracting Pool and Leisure Centres
2. Road and Streetlight Maintenance
3. 1995-96 Territory Operating Loss
4. ACT Public Hospitals - Same Day Admissions
Non Government Organisation - Audit of Potential Conflict of Interest
5. Management of Leave Liabilities
6. The Canberra Hospital Management’s Salaried Specialists Private Practice
7. ACT Community Care - Disability Program and Community Nursing
8. Salaried Specialists’ Use of Private Practice Privileges
9. Fleet Leasing Arrangements
10. Public Interest Disclosures - Lease Variation Charges and Corrective Services
11. Annual Management Report for Year Ended 30 June 1997
12. Financial Audits with Years Ending to 30 June 1997

¹⁶ 46 Reports were issued prior to 1996. Details can be obtained from the ACT Auditor-General’s Office or the ACT Auditor-General’s homepage: <http://www.audit.act.gov.au>.

13 Management of Nursing Services

Reports Published in 1998

- 1 Management of Preschool Education
- 2 Lease Variation Charges - Follow-up Review
- 3 Major IT Projects - Follow-up Review
- 4 Annual Management Report for Year Ended 30 June 1998
- 5 Management of Housing Assistance
- 6 Assembly Members' Superannuation and Severance Payments to Former Members' Staffers
- 7 Magistrates Court Bail Processes
- 8 Territory Operating Losses and Financial Position
- 9 Financial Audits with Years Ending To 30 June 1998
- 10 Management of Schools Repairs and Maintenance
- 11 Overtime Payment To A Former Legislative Assembly Member's Staffer

Reports Published in 1999

- 1 Stamp Duty on Motor Vehicle Registrations
- 2 The Management of Year 2000 Risks
- 3 Annual Management Report for Year Ended 30 June 1999
- 4 Financial Audits With Years Ending to 30 June 1999

Reports Published in 2000

- 1 Bruce Stadium Redevelopment — Summary Report
- 2 Bruce Stadium Redevelopment — Value for Money
- 3 Bruce Stadium Redevelopment — Costs and Benefits
- 4 Bruce Stadium Redevelopment — Decision to Redevelop the Stadium
- 5 Bruce Stadium Redevelopment — Selection of the Project Manager
- 6 Bruce Stadium Redevelopment — Financing Arrangements
- 7 Bruce Stadium Redevelopment — Stadium Financial Model
- 8 Bruce Stadium Redevelopment — Actual Costs and Cost Estimates
- 9 Bruce Stadium Redevelopment — Market Research and Marketing
- 10 Bruce Stadium Redevelopment — Stadium Hiring Agreements

- 11 Bruce Stadium Redevelopment — Lawfulness of Expenditure
- 12 Bruce Stadium Redevelopment — Governance and Management
- 13 Annual Management Report for the Year Ended 30 June 2000

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