Volume 4.0 Monitoring / Assessment

Overview of Volume 4

Volume 4 discusses the range of processes, tools and reports that should be employed when monitoring and assessing an agency's performance in the delivery of its services; the effectiveness of outsourcing arrangements; machinery of Government changes; and, consideration of internal/external audit findings.

The *Financial and Performance Management Standard 2009* requires agencies to have regard to the Handbook when establishing their internal control systems and processes. Agencies must comply with the Handbook when they apply to agency circumstances. Agencies will therefore need to be mindful of this requirement when establishing and implementing internal financial controls and operational processes.

This Volume consists of the following Information Sheets:

Reference	Information Sheet Title	Date Issued
4.1	Monitoring and Assessment of Internal Controls	January 2017
4.2	Statement by Chief Finance Officer	January 2017
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Information Sheet 4.1 – Monitoring and Assessment of Internal Controls

Introduction

Monitoring an agency's systems of internal controls is an essential tool in assessing the effectiveness of the delivery of the agency's objectives and services. Poorly designed or ineffective internal controls can result in fraud, waste, abuse and mismanagement. Regular reviews of internal controls enable management to respond in a timely manner to irregular, unethical, uneconomical, inefficient and ineffective internal control processes and systems.

This Information Sheet is intended to assist agencies in the development and implementation of processes for monitoring internal controls and systems, the assessment of the results of the monitoring process, and recognition of potential changes to internal processes that may result.

Monitoring

Section 15(3) of the *Financial and Performance Management Standard 2009* (the Standard) requires agencies to undertake regular reviews of their internal controls and systems, including financial and risk management systems.

Key internal controls must be documented, with a risk assessment undertaken as to the importance of the controls to the agency. This may determine the extent and frequency of reviews undertaken. Other factors which may influence the extent and frequency of reviews include:

- material changes that may have occurred since the last review, the extent of risks resulting from those changes, and the agency's ability to respond to such risks or changes
- the frequency and extent of weaknesses identified as a result of the monitoring process, and the impact of these on the agency's performance, and
- impacts of changes in the agency's financial, regulatory or compliance environments.

Where weaknesses are identified, each weakness should be evaluated and appropriate remedial action taken. Details of corrective actions taken and changes to agency internal controls and processes must be communicated to appropriate agency staff and stakeholders. Recognition of staff diligence in identifying system weakness and omissions should provide an incentive for staff to be proactive in monitoring agency internal controls.

Approaches to monitoring

Internal controls monitoring should be undertaken on a continuous basis as part of an assessment plan, or as targeted/specific assessments for higher risk situations.

Continuous monitoring

Continuous monitoring should be integrated into the day-to-day financial processes of the agency to provide management with an ongoing assessment of the effectiveness of systems, processes and internal controls in the delivery of agency services.

Continuous monitoring of an agency's systems of internal controls may:

- confirm that internal control systems are operating as intended
- confirm that documented processes accord with what occurs in practice
- reflect changes in agency objectives and/or operating environment
- identify processes required to rectify any deficiencies or omissions in agency internal control systems
- identify redundant or duplicated processes
- identify opportunities for the application of new or upgraded technology, and
- be reviewed in conjunction with agency financial management practice manuals.

It is suggested that in the development of the monitoring process, regard should be given to:

- the nature of the agency's activities
- the size and complexity of the agency's operations
- internal control and system strengths and weaknesses that may impact on effective operations
- issues raised by the internal or external auditors
- the process for implementation of appropriate changes to operational processes in response to issues identified, and
- the need to effectively communicate the results of the monitoring process.

Targeted/specific monitoring

Agency management may elect to target specific processes or functions for additional monitoring (for example, high risk cash or payroll transactions). The objective will be to determine if existing processes are working effectively, and minimise potential losses through the timely application of appropriate remedial action.

The decision to undertake targeted monitoring may be as a result of:

- weaknesses identified, for example, by agency staff or internal audit
- results noted from regular monitoring activities, such as the frequency of discrepancies or omissions
- particular processes, or areas of agency operations which may be of concern
- changes to the 'business' of the agency
- staff changes, or
- the identification of obvious areas for potential cost/loss (for example, cash, inventory, etc).

Circumstances may also arise where monitoring may be more effective if conducted by a person/body independent of an agency's day-to-day operations and it may be appropriate to engage external consultants.

Engagement of an independent person/body would be for support and advice only. Management cannot abrogate responsibility for monitoring systems and controls.

Assessment of controls and systems

Assessment of controls and systems enables management to evaluate potential impacts, develop rectification plans and implement changes to internal controls and systems. This process should assist agency management to:

- evaluate the results of monitoring undertaken
- determine if the potential impact is within the agency's risk tolerance level
- identify internal control or system weaknesses and options for cost-effective remedial solutions (for example, informal or 'soft' control processes)
- make changes to internal controls and systems, and
- adapt monitoring processes to assess the effectiveness of previously identified corrective actions to internal controls and processes.

There are many self-assessment tools available on the internet to assist agencies with reviewing their systems and controls. Agencies are encouraged to consider the tools available to determine the best approach for their particular 'business' and circumstances.

Reporting of weaknesses and remedial strategies

Internal control and system weaknesses should be promptly reported to the chief finance officer (or statutory body equivalent) for assessment and development of appropriate rectification strategies. The chief finance officer (or statutory body equivalent) may wish to consult with either internal or external audit for advice on the rectification strategies, particularly if the weaknesses were initially identified by audit.

Significant and recurring weaknesses should be reported to the audit committee for their consideration and endorsement of proposed remedial strategies.

Potentially significant issues may also need to be reported to the accountable officer or statutory body, particularly if approvals are required for significant process or system changes, or changes to the financial management practice manual.

The risk management committee (or equivalent) may also need to be informed of any weaknesses for consideration and possible inclusion in the risk register (where established).

Any system or process changes must be communicated to other staff or agencies as appropriate, for example, the internal and external auditors.

In instances where fraud is suspected, staff should advise the accountable officer / chair, the chief finance officer or equivalent, or the head of internal audit or equivalent. Alternatively, employees can contact the Queensland Audit Office or the Crime and Corruption Commission. As a first point of reference, employees should refer to their agency's fraud policy for advice.

Under the *Public Interest Disclosure Act 2010* (PID Act), agencies are required to make arrangements for public disclosures to be made and received anonymously. The PID Act also requires agencies to make their reporting arrangements known publicly on the agency's website.

Related resources

- INTOSAI Guidelines for Internal Control Standards for the Public Sector, Internal Control Standards Committee, Belgium
  http://www.intosai.org/en/issai-executive-summaries/intosai-guidance-for-good-governance-intosai-gov.html

Further information

If you have any questions concerning the Financial Accountability Handbook, please contact your Treasury Analyst.

Alternatively, email the Financial Management Helpdesk (fmhelpdesk@treasury.qld.gov.au) with details of your query and a response will be provided.

Information Sheet 4.2 – Statement by Chief Finance Officer

Introduction

Accountable officers and statutory bodies are responsible for the efficient, effective and economical operation of their agencies. To discharge this responsibility, they may delegate certain functions to other officers within the public sector.

Section 77 of the *Financial Accountability Act 2009* (the Act) requires, for departments only, accountable officers to delegate the establishment and review of financial internal controls to the chief finance officer (CFO). Section 77(2)(b) of the Act further provides that the CFO must provide an annual statement to the accountable officer about whether appropriate financial controls are in place and operating effectively.

This Information Sheet is designed to assist departments in implementing the requirements of this statement.

Legislative requirements

As detailed in *Information Sheet 2.5 – Chief Finance Officer*, the Act requires an accountable officer to nominate an officer to the position of CFO. Financial resource management is a key responsibility of this role and encompasses the establishment, maintenance and review of financial internal controls and processes.

The Act also prescribes that the CFO must provide a statement to the accountable officer each financial year about whether the financial internal controls of the department are operating efficiently, effectively and economically. The *Financial and Performance Management Standard 2009* (the Standard) prescribes that the CFO must provide the statement before or at the same time the CFO certifies the annual financial statements for the department. The Standard also prescribes that the statement must include, as a minimum, whether:

a) the financial records of the department have been properly maintained throughout the financial year in accordance with the prescribed requirements

b) the risk management and internal compliance and control systems of the department relating to financial management have been operating efficiently and effectively throughout the financial year

c) since the balance date, there have been any changes that may have a material effect on the operation of the risk management and internal compliance and control systems of the department, and if so, details of the changes, and

d) external service providers have given assurance about their controls.

Each of these elements is considered in detail below.

Financial records

This requirement is about whether records to support the financial management of the agency have been properly maintained. There are a number of legislative requirements and Government policies which direct how public records should be stored and maintained. These include:

- *Public Records Act 2002*
- *Evidence Act 1977*
- Information Standards and policies issued under the Queensland Government Enterprise Architecture and managed by the Queensland Government Chief Information Office, and
- General Retention and Disposal Schedule for Administrative Records policy released by the Queensland State Archives.

Further information about financial record management is available in *Information Sheet 5.3 – Financial Record Management.*

Risk management and internal compliance and control systems

Two of the responsibilities that the accountable officer must delegate to the CFO under the Act are:

- financial resource management, including the establishment, maintenance and review of financial internal controls, and
- provision of advice concerning the financial implications of, and financial risks to, the department's current and projected services.

This requirement directly relates to providing assurance to the accountable officer over these two responsibilities.

Further information about risk management and internal controls is available in *Information Sheet 2.3 – What are Internal Controls?*, *Information Sheet 3.1 – Risk Identification and Management*, *Information Sheet 3.2 – Internal Control Structure*, *Information Sheet 4.1 Monitoring and Assessment of Internal Controls* and *A Guide to Risk Management.*

Post-balance date events

While the CFO statement covers the entire financial year, there is a risk that a significant event may occur after balance date which could have an impact on the assertions made by the CFO.

Such events may include, but are not limited to:

- system changes
- machinery of Government changes
- staff changes, or
- economic factors.

Where possible, the impact of these events should be identified and/or quantified.

External service providers

The majority of departments rely on external service providers for their financial processing and IT functions – in particular Queensland Shared Services. Despite any outsourcing arrangements, the accountable officer remains responsible for the agency's financial transactions. Therefore, the department must have processes to monitor the performance of the external service provider/s. The CFO is responsible for assessing the appropriateness of the assurance provided by external service provider/s.

If issues are identified, the CFO should undertake appropriate action to obtain assurance over the work performed by the external service provider. For example, the CFO could select a sample of transactions to confirm to source documentation and take remedial action under the services contract if appropriate.

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

Further information about external service providers is available in *Information Sheet 4.4 – Outsourced Arrangements*.

Practical application

The Standard requires the CFO to attest that the systems are operating efficiently and effectively <u>throughout the financial year</u>, not just at year end or when the assessment is taking place. Given the wide range of transactions and financial controls in place in most agencies, it would be difficult to attest to each one. It is therefore considered reasonable that a risk-based approach be adopted.

A department's strategic and operational plans, with its risk register, may be a good starting point to identify the agency's significant threats. However, its broader, higher-level focus may not be sufficient to be of significant use for the CFO statement. As such, it may be beneficial for the CFO to maintain a finance-specific perspective of known threats to identify risks relevant to his/her mandated responsibilities and determine where assurance work should be targeted.

A finance-specific risk analysis may identify exposure arising from a particular function, cost centre or control that warrants regular monitoring. For example, following a machinery of Government change, the CFO may focus the majority of attention to the functions that have transferred in due to familiarity with and confidence in the controls over existing functions. Other possible higher risk areas may include:

- politically or financially sensitive functions or systems
- changes in key personnel
- new or upgraded information systems
- internal restructuring
- introduction of new functions or the expansion of existing functions, and
- changes to, or the introduction of, any outsourcing arrangements.

Many of the recognised risks would most likely result from general knowledge of the agency and the processes employed. However, risks may also be identified by other sources, such as internal or external audit. It may be useful to record and categorise risks in a register.

If the CFO plans on relying on a finance-specific risk register as support for the annual CFO statement, the risks recorded in the register should be regularly reviewed to ensure they have not changed.

Some basic points that a CFO would normally address when developing a risk-based approach include:

- determining whether the significant systems and processes documented in the financial management practice manual:
  - are functioning and being complied with as documented
  - remain appropriate and relevant to the department's operations, and
  - are cost-effective, efficient and minimise risk.
- determining the frequency of reviews. There are a number of ways this could be established, depending upon the assurance framework established. The following approaches could be considered:
  - if a 'systems appraisal' approach is used, all systems would be periodically assessed. Rolling evaluations could be performed over a three or five year timeframe, unless particular risks are identified which warrant more frequent investigation.
  - if a risk-based approach is established, risk ratings could be applied to identified threats which then inform the frequency of reviews. One example may be:
    - a high risk control may be assessed every year
    - a medium risk control may be assessed every three years, and
    - a low risk control may not be individually assessed as sufficient comfort can be obtained without specific reviews.
- using a survey approach, where regional managers or specified personnel are asked to certify to the satisfactory operation of controls within their area. While surveys could not be used as the sole evidence of the controls, they could be used as supporting assurance. When designing a survey, it may be beneficial for the CFO to target questions to the specific area, rather than asking generic questions which may create a 'tick-box' mentality. For example, a regional manager may be asked about whether independent checks have been enforced in a small office, or key personnel (such as the chief information officer) may be asked about functions under their control.

While the CFO cannot delegate responsibility for the review of internal control systems to another person or body, consideration could be given to engaging external consultants or persons independent of the finance area to conduct reviews such as those illustrated above. The review process may also be undertaken by the CFO or the internal audit function, if approved by the accountable officer. If internal audit is able to critically review controls and systems and produce robust reports, this would add significant value as part of the review of the internal control system.

Professional judgement will be required in developing and implementing internal control assessments. *Information Sheet 4.1 – Monitoring and Assessment of Internal Controls* provides further information about internal controls.

The complexity involved in obtaining the assurance required to certify the CFO statement may be compounded by the need to complete appropriate checks across regionalised functions, outsourced arrangements and differing finance processes within the same agency.

Refer to *Information Sheet 4.3 – Regionalised Functions* and *Information Sheet 4.4 – Outsourced Arrangements* for further information on regionalised functions and outsourced arrangements.

Frequency of CFO statements

The Act requires a CFO statement to be produced every financial year. Generally, only one statement will be prepared for any given financial year. There may be circumstances, however, when more than one CFO statement may be appropriate, for example:

- at the request of the accountable officer.
- if a CFO leaves the department, the outgoing CFO should provide a statement to the accountable officer on the efficiency, effectiveness and economy of the financial controls in operation to the date of termination. The statement should also be made available to the incoming CFO.
- if there is a machinery of Government change, it may be appropriate for a CFO statement to be prepared as at the date of the change. For example, if a department is split into a number of departments, the CFOs of the new departments need assurance about the controls of their functions prior to the change.

Preparing the CFO statement

There are no rules regarding what should be included in the CFO statement (other than reference to the minimum disclosures in the Standard). The format of the CFO statement should be discussed and agreed with the accountable officer early, as this will largely be dictated by the type of information/assurance the accountable officer is seeking.

Some points to consider when determining the contents of the CFO statement:

- some overarching background information about the internal control and assurance frameworks used may provide the reader with context for and scope of the review
- information about significant areas of concern should be disclosed. Where possible, the statement should contain information about the nature of the concern, the potential impact of it, and what action has been or is being taken to address the exception
- the status of issues reported in the prior year, and
- information about general improvements to internal controls that have been identified and will be implemented.

Supporting documentation

Appropriate documentary evidence should be available to support the annual statement provided to the accountable officer. This may take the form of individual workpapers or other documents, such as surveys/assurance statements provided by other areas of the agency or by an outsourced provider. The documentation should detail the processes and evidence relied upon to support the CFO's decision to sign the statement.

Supporting documentation prepared by the CFO should outline other appropriate techniques used where detailed testing or verification has not been undertaken. For example, there may be compensating controls that provide sufficient levels of assurance, or the materiality of the associated financial or non-financial impact may not justify further examination, or a rolling evaluation approach may be used. The supporting work papers may also include wider corporate governance, planning and decision making documents where these contribute to providing a level of comfort over the validity of control structures.

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

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

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

The intent of principles-based legislation is to allow systems and processes to be tailored to meet individual agency circumstances. The CFO should exercise appropriate discretion to ensure this flexibility is utilised through systems and processes that are cost-effective and appropriate to the size, complexity and operations of the agency.

Controlled entities

The Standard provides that where an agency controls another entity (such as a company), then the agency's internal control structure must include procedures for monitoring the performance of, and accounting for its investment in, the other entity (section 8(2)(b)(iii)).

The existence of a controlled entity exposes the department to additional risk and consideration should be given to the controls in place. The potential impact of a controlled entity on the CFO statement may depend upon the materiality of and risks attached to the controlled entity. If a department has a material or high risk controlled entity, the CFO may seek to receive assurances from the person responsible for monitoring the company about the procedures in place to review the performance of the company for inclusion in his/her CFO statement. The audit certification of the company's accounts would provide assurance that the accounts present a true and fair view of the company's financial operations and cash flows which are reported in the department's consolidated financial statements.

Audit committee

There is no legislative requirement for the audit committee to be involved with the CFO statement. A department may, however, find it beneficial to have audit committee involvement and input into the CFO statement process. This would be a matter for discussion between the accountable officer, the CFO and the audit committee.

The CFO statement may be enhanced by audit committee feedback regarding the framework a CFO plans to use to get assurance, the proposed format of the statement, or even the draft statement before it is presented to the accountable officer (that is, it could be given to the audit committee with the final draft financial statements for review and comment).

Conversely, the audit committee may find involvement in the CFO statement process useful in gaining a better understanding of the department, its processes and risks. This will, in turn, assist the audit committee with its role in providing independent advice to the accountable officer.

For further information about audit committees and their relationship with CFOs, refer to the *Audit Committee Guidelines: Improving Accountability and Performance*.

Application to statutory bodies

While the delegations of minimum responsibilities to a CFO position have been mandated for departments only, where a statutory body is of sufficient size and complexity, a similar structure and process is strongly encouraged.

Smaller statutory bodies also need to undertake regular assessments of their controls, and will need to develop an appropriate approach for their agency and its 'business'.

Related resources

- A Guide to Risk Management, Queensland Treasury
  http://www.treasury.qld.gov.au/office/knowledge/docs/risk-management-guide/index.shtml
- Audit Committee Guidelines: Improving Accountability and Performance, Queensland Treasury
  http://www.treasury.qld.gov.au/office/knowledge/docs/improving-performance/index.shtml
- Annual Report Requirements for Queensland Government Agencies, Department of the Premier and Cabinet
  http://www.premiers.qld.gov.au/publications/categories/policies-and-codes.aspx
- INTOSAI Guidelines for Internal Control Standards for the Public Sector, Internal Control Standards Committee, Belgium
  http://www.intosai.org/en/issai-executive-summaries/intosai-guidance-for-good-governance-intosai-gov.html

Further information

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Information Sheet 4.3 – Regionalised Functions / Independent Units

Introduction

As a result of the geographic size of Queensland and the range of agency services and functions provided by Government, some agencies have established regional operations to better manage delivery of these services to the public.

While the accountable officer has ultimate responsibility for the delivery of a department's objectives and services, agency management must support the accountable officer in this endeavour. Specifically, the chief finance officer (CFO) is responsible to the accountable officer for the efficient, effective and economical operation of the agency's financial internal controls, including those in regional operations.

This Information Sheet is intended to assist agencies in understanding general issues attaching to regionalised agency operations and activities, and specifically refers to the preparation of the annual CFO statement. While it is acknowledged that the Information Sheet is directed primarily towards departments, statutory bodies may find elements in the Information Sheet useful if they are operating under similar circumstances.

Independent units within an agency, such as a commercialised business unit, may follow processes similar to those of regionalised functions.

What is regionalisation?

Regionalisation allows for increased flexibility in the delivery of agency services to regional Queensland. It is the process of transferring financial and operational authorities and responsibilities to a region or remote area. This, in turn, requires regions to have the capacity and capability to effectively undertake those authorities and responsibilities in the delivery of the agency's objectives and services.

Implications for CFO statement

There may be different levels of regionalisation with regard to operational, functional and corporate responsibilities, depending upon location, population, service delivery requirements and specific regional needs. For example, internal processes and controls applied to a regional school may be significantly different from those in operation at a school in Brisbane.

As a result, a 'one-size-fits-all' approach cannot be used by CFOs to obtain assurance over regionalised functions or independent units. Instead, the strategies used to assess the controls should target specific regional environments and potential risks that may be identified as a result.

CFOs should not rely on a single strategy for assessing the operation of regional locations. A complementary mix of appropriate strategies should be developed, such as the strategies used in monitoring and assessing outsourced arrangements (refer *Information Sheet 4.4 – Outsourced Arrangements*).

Regionalised Functions / Independent Units

Strategies include, for example:

- requiring lodgement of monthly, quarterly or annual statements to the CFO certifying that internal financial controls and processes have been properly implemented and are working as intended (officers should be made aware of their responsibilities in signing such a statement)
- assessing reports provided by external or internal audit units
- establishing regular and structured communication channels within and between regions, through regional networking groups whose purpose is to act as a forum for discussion of topical issues and areas of concern
- providing regular training programs and awareness sessions to regional staff to maintain and reinforce agency operational requirements
- analysing regional financial reports, with matters identified being dealt with and documented accordingly, and
- reviewing regionalised financial processes to ensure they do not conflict with overall agency financial controls and processes.

Where the CFO is of the opinion that a regional location's application of financial controls does not meet agency requirements, additional testing may be performed and remedial action taken to rectify the anomalies noted.

The CFO's assessment of the results of the review process will assist in validation of the regional or remote area's performance that will be included as part of the CFO statement (refer to *Information Sheet 4.2 – Statement by Chief Finance Officer*).

Further information

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Alternatively, email the Financial Management Helpdesk (fmhelpdesk@treasury.qld.gov.au) with details of your query and a response will be provided.

Information Sheet 4.4 – Outsourced Arrangements

Introduction

Outsourcing may be defined as the process where an agency enters into an agreement with another entity (either within the public sector or in the private sector) to perform operational, financial or other administrative activities which currently are, or could be, undertaken by the agency itself. Examples of functions commonly outsourced include IT operations, document processing, payroll, internal audit and debt collection.

In evaluating the use of outsourced arrangements agencies must consider the requirements of the Queensland Government Policy on the Contracting-out of Services (Contracting-out Policy) and the Employment Security Policy (ES Policy). The Contracting-out Policy sets the requirements for contracting-out proposals. The ES Policy promotes developing and maintaining a government workforce as the preferred provider of existing services to Government and the community. Cabinet approval is required for all major organisational change and restructuring in agencies that will significantly impact on the Government workforce such as significant job reductions or alternative service delivery arrangements.

As part of the process to assess whether its services are providing the best value for money, an agency may test the market to determine whether it is providing the public with the best possible solution at the best possible price. This process may result in a decision to outsource service arrangements.

If an agency outsources a financial management function which is mandated under the *Financial Accountability Act 2009* or the *Financial and Performance Management Standard 2009*, the agency retains responsibility for ensuring that the outsourced agency functions are subject to the same level of rigorous scrutiny that applies to internal operating systems. Where appropriate, additional controls specific to those functions should be implemented. Use of outsourced services does not allow an agency to abrogate its responsibility for the outcomes of, and potential negative impacts on, agency operations. That is, the agency retains the responsibilities associated with transactions or functions performed by a service provider – the responsibility cannot be transferred to the external party.

This Information Sheet is intended to assist agencies with implementing processes to introduce and manage an outsourced financial management arrangement.

The need to outsource

In assessing the need to outsource agency functions, it is suggested that the agency, as a minimum:

- prepares a business case detailing reasons for, and benefits and costs of, outsourcing the selected functions including reference to the application of the ES Policy
- prepares a risk assessment analysis
- establishes appropriate internal controls, and
- obtains accountable officer or statutory body approval.

If Cabinet approval of an outsourcing proposal is to be sought, the Contracting-out Policy mandates what the submission must detail.

Once approval is obtained that outsourcing is the appropriate option, Cabinet approval must be obtained under the ES Policy for all major organisational change and restructuring within an agency.

Benefits and costs

The Contracting-out Policy strives to achieve “best value” delivery of services to the community together with the Government’s emphasis on pursuing performance improvement strategies for its workforce. It is recognised that while benefits can accrue to agencies in outsourcing certain functions, potential costs may be incurred that offset the benefits.

Benefits that may be identified from outsourcing agency functions include:

- savings in both fixed and recurring agency costs
- reductions in capital expenditure and investment in infrastructure previously required to support agency functions now outsourced
- reductions in staff costs, through reduced reliance on key staff, training and need for specialised skills
- an ability to redirect agency staff and resources to achieve better delivery of agency outputs and objectives,
- access to specialist skills, and
- demonstrated service enhancements to Government and the community.

Costs which may offset the benefits noted above include:

- reliance on outsourcing provider to give ‘value for money’
- agency management and supervisory costs do not reduce
- loss of specialised skills
- loss of control over previous in-house functions
- reliance on the performance of the outsourcing provider
- lack of flexibility and control of outsourced agency operations,
- possible erosion of internal control processes, and
- social and economic implications, particularly in regional and rural centres where the Government is committed to maintaining employment.

Assessment

The Contracting-out Policy sets out the requirements for contracting-out proposals for:

- services currently provided in house
- new services, and
- services in replacement facilities

Depending on the scale, importance and complexity of the internal function to be outsourced, an appropriately representative project team should be formed to undertake a detailed assessment of the proposal.

As part of the assessment process, it is recommended that management ensure that the Contracting-out Policy is complied with. Additionally, the following matters should be considered:

- are each party's roles and responsibilities clearly determined?
- is there need for an agency officer to assume responsibility for oversighting/managing the outsourced arrangements?
- have appropriate controls for externally processed data been designed and implemented?

While it is recognised that the use of private sector outsourcing organisations may be limited, it is suggested that the initial assessment should be extended to include:

- an assessment of the financial viability of the provider
- the provider's ability to deliver the outsourced services
- a review of the provider's accreditation and quality assurance standards
- a review of the provider's risk assessment processes, and
- clarification of ownership rights to intellectual property, if applicable.

Management recommendation

At the completion of the evaluation process, the accountable officer or statutory body, with the assistance of agency management, has the responsibility to assess the proposal's overall benefits, and recommend that a proposal be made (or not made) in accordance with the Contracting-out Policy, noting that the requirements of the ES Policy are to be applied also.

Cabinet approval under the Employment Security Policy (ES Policy) and the Contracting-out of Services Policy (Contracting-out Policy)

Under these policies contracting-out decisions and organisational change need to demonstrate clear benefits and enhanced service delivery to the community with a focus on performance improvement strategies for best value delivery of services.

In brief, Cabinet approval is required for:

- proposals to contract-out:
    - currently provided in-house services
    - new services, and
    - services in replacement facilities.
- all major organisational change and restructuring in agencies that will:

- o significantly impact on the Government workforce such as significant job reductions, deployment to new locations or alternative service delivery arrangements, or
- o have major social and economic implications, particularly in regional and rural centres where the Government is committed to maintaining Government employment. Proposals affecting these centres need to carefully evaluate the impact on communities to ensure that short-term efficiency gains are balanced against the long-term social and economic needs of these communities.

Service Level Agreement

If an outsourcing arrangement is proposed by management and ultimately Cabinet (where required), then an Operating Level Agreement or a Service Level Agreement, with appropriate terms and conditions, should be developed and signed by the agency and the outsourcing provider. The agreement should outline deliverables and clearly differentiate between the responsibilities of the respective parties. The agreement may also address the information to be provided to the chief finance officer (CFO) for the purposes of preparing the CFO statement about the efficiency, effectiveness and economy of the internal controls relating to the agency.

Ongoing internal control processes

Agencies need to be aware of the changes that will result from the adoption of outsourcing arrangements, and design and implement internal control processes accordingly. In outsourced arrangements, controls can be implemented at various points in the processing cycle, for example:

- prior to despatch to an outsourcing agency, ensuring correct and complete application of internal control processes to all documents
- recording appropriate details of documents despatched for processing, such as dollar amounts, batch codes, batch dates and document sequence numbers, and
- verifying data, documents and reports received from the provider with previously recorded details, to ensure full and correct processing by the outsourcing agency.

While it is expected that outsourcing providers would make every effort to ensure processing accuracy, their lack of agency knowledge could lead to inadvertent, but significant, processing errors. Examples can include:

- inadvertent, or deliberate, errors in agency approvals may not be detected, or
- transactions coded or processed to incorrect general ledger account numbers or cost centres may not be detected.

Monitoring of outsourced arrangements

Once an outsourcing arrangement takes effect, an “out of sight, out of mind” approach must not be adopted. Management should regularly review outsourced functions to assess whether it remains appropriate to outsource agency functions, and whether the quality of the service meets the standards required by the agency in the delivery of its services.

Techniques that may be used to assess the performance of a service provider include:

- logging, reviewing and resolving issues raised by agency staff on the quality of the outsourced services
- testing a sample of processed transactions to ensure reliance can be placed on the work performed
- reviewing transaction reports and error logs
- developing performance measures, such as:
  - processing error rates
  - processing transaction times, and
  - time taken to respond to queries for advice
- regularly assessing performance measures, with appropriate follow up
- undertaking satisfaction surveys with agency staff, and
- ensuring regular communication between agency and the outsourcing provider on matters such as:
  - processing performance, accuracy and timeliness of reporting
  - additional agency functions considered appropriate for outsourcing
  - the outsourcing provider's plans for changes or enhancements to current services, or
  - other matters considered relevant between the parties.

Assurance

Section 77(2)(b) of the *Financial Accountability Act 2009* (the Act) requires the CFO to provide the accountable officer with "a statement about whether the financial internal controls of the department are operating effectively, efficiently and economically".

Section 57 of the *Financial and Performance Management Standard 2009* provides that one component of the CFO statement must be "whether external service providers have given assurance about their controls".

It is expected that a service provider would provide a comfort letter (or similar) to the department about the provider's controls. However, a CFO should not rely solely on this comfort letter for assurance for the CFO statement. Additional processes should be implemented to allow the CFO to corroborate the service provider's claims.

These processes should reflect the sensitivity, complexity and potential risk exposure of the services undertaken by an outsourcing provider on behalf of the agency, and can include:

- those processes identified above under the heading "Monitoring of outsourced arrangements"
- establishment of appropriate internal control processes
- targeted assessment of specific functions identified as critical to agency operations, and
- regular management review of the results of the services provided under the outsourced arrangement.

Specific issues applicable to the head of internal audit

Australian Auditing Standard *ASA 402 Audit Considerations Relating to an Entity Using a Service Organisation* establishes mandatory requirements for the audit of agencies using outsourcing providers. While ASA 402 applies to the audit of financial reports in accordance with the *Corporations Act 2001*, paragraphs 7 to 18 contain useful information which may be incorporated into internal audit processes to review outsourced arrangements in the public sector.

Related resources

- ASA 402 Audit Considerations Relating to an Entity Using a Service Organisation, Auditing and Assurance Standards Board
  http://www.auasb.gov.au/Home.aspx
- The Australian Prudential Regulation Authority has a number of resources about managing outsourcing arrangements
  http://www.apra.gov.au
- Employment Security Policy, Queensland Treasury
  https://www.treasury.qld.gov.au/fair-safe-work/public-sector-industrial-relations/index.php
- Queensland Government Policy on the Contracting-out of Services
  https://www.treasury.qld.gov.au/fair-safe-work/public-sector-industrial-relations/index.php

Further information

If you have any questions concerning the Financial Accountability Handbook, please contact your Treasury Analyst.

Alternatively, email the Financial Management Helpdesk (fmhelpdesk@treasury.qld.gov.au) with details of your query and a response will be provided.

Information Sheet 4.5 – Audit Findings and Resolution

Introduction

This Information Sheet is intended to assist agencies in discharging their obligations in relation to weaknesses and breakdowns in internal controls and processes identified by the internal or external auditors.

Legislative requirements

External audit

Section 62(1)(c) of the *Financial Accountability Act 2009* (the Act) states that departments and statutory bodies must have their annual financial statements audited by the Auditor-General within the time stated in the Standard.

Under section 54 of the *Auditor-General Act 2009* (the A-G Act), a report may be prepared by the Auditor-General on any audit conducted under the A-G Act and may include observations and suggestions about anything arising out of the audit. Section 54(4) of the A-G Act further states that if any of these observations or suggestions require attention or further consideration, the Auditor-General must give them and any applicable comments to:

- the accountable officer and any other person whom the Auditor-General considers to have a special interest in the report (if they arose out of an audit of a department), or
- the chief executive officer or chairperson of the entity and the person responsible for the financial administration of the entity, and any other person the Auditor-General considers to have a special interest in the report (if they arose out of an audit of another entity).

Under section 54(5) of the A-G Act, if the Auditor-General considers that matters raised are of significance, the Auditor-General must refer those matters to the appropriate Minister and the Treasurer.

Sections 63 and 64 of the A-G Act provide that the Auditor-General may report significant issues to Parliament.

Internal audit

Section 32 of the *Financial and Performance Management Standard 2009* (the Standard) details the reporting obligations of the internal audit function on matters identified during the conduct of the audit which, in its opinion, should be brought to the attention of the agency.

Section 32 also provides that the internal audit function of an agency must:

- give the person in charge of an audited area a copy of the proposed report on the audit for the area, and
- include any comments by the person about the proposed report in the final report.

The internal audit function must give a copy of the final report to:

- for a department – the accountable officer and its audit committee, and
- for a statutory body – the statutory body and its audit committee (if established).

Resolution of audit issues

Agency follow up of audit issues is an integral part of good management. Responsibility for the assessment and resolution of financial audit issues raised may be delegated by the accountable officer or the statutory body to the chief finance officer (or statutory body equivalent) or other officer within the agency. Operational matters may be delegated to the appropriate area line manager.

Agencies must have systems in place to ensure audit issues are addressed in a timely manner. For example, a member of the agency's senior management could be delegated responsibility for following up on the status of audit findings, or a register of audit findings could be maintained to manage and monitor audit findings. The use of a register is discussed in further detail below.

Audit should be advised of the actions taken by agencies in response to recommendations received. Either internal or external audit may conduct follow-up reviews to determine whether the remedial actions have addressed the issues raised to audit's satisfaction.

The audit committee (where established) should monitor the register of audit findings (where used) and endorse or reject proposed resolution measures. As a minimum, high-risk issues should be reported to the audit committee and/or the risk management committee. The document *Audit Committee Guidelines – Improving Accountability and Performance*, issued by Queensland Treasury, includes a number of references to audit committees having an important role around monitoring and assessing audit findings.

Where audit recommendations receive partial acceptance or are not accepted by an agency, the justification for such decisions should be documented, with the accountable officer or statutory body advised of, and supporting, the decision concerning the audit recommendations.

Where external audit recommendations are not adopted, the auditor may consider the matter to be unresolved. Where an unresolved matter is considered 'significant', the Auditor-General may include details in a report to Parliament.

It is important that any remedial actions resulting from audit findings be cost effective, taking into account the risk profile of the issue identified and alternative solutions to rectify the deficiency identified by audit. Solutions that are not cost effective should be avoided.

Register of audit findings

Agencies may consider establishing a Register of Audit Findings to record matters arising from the internal and external audit processes and to assist in tracking progress on outstanding issues raised. The register could be as simple as a spreadsheet. The register should record matters such as:

- the audit issue
- management responses
- issue risk rating
- officer responsible for issue resolution, and
- the status of the issue (for example, whether remedial actions have been finalised).

The register should record reasons for non-acceptance of audit recommendations.

The need for a register should be based on:

- the size, nature and complexity of the agency's operations
- assessment of inherent risk areas within the agency, and
- prior audit history.

Where a register is maintained, it should be regularly reviewed to ensure appropriate action is being taken to follow up on issues. For example, the chief finance officer (or statutory body equivalent) might assume responsibility for monitoring progress of audit issues relating to the finance function of the agency. The register should be tabled as a standing agenda item at audit committee meetings for review/discussion, as appropriate.

Related resources

- Audit Committee Guidelines – Improving Accountability and Performance, Queensland Treasury
  http://www.treasury.qld.gov.au/office/knowledge/docs/improving-performance/index.shtml

Further information

If you have any questions concerning the Financial Accountability Handbook, please contact your Treasury Analyst.

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Information Sheet 4.6 – Machinery of Government

Introduction

Machinery of Government (MoG) changes may occur at any time, but are most common following an election or a change of Government. These are known formally as changes to administrative arrangements. The changes may range from the abolition of a department with transfer of that agency's entire responsibilities to another department, the creation of a new department, or minor changes within and between existing departments. Consideration must be given to matters such as governance, delegations, financial systems and agency policies when assessing MoG impacts on agency operations.

This Information Sheet is intended to assist agencies with some of the issues that need to be considered following a MoG change. It does not provide guidance on the reporting of MoG changes in agencies' financial statements. The *Financial Reporting Requirements for Queensland Government Agencies* (FRRs) published by Queensland Treasury deal with agency obligations in this regard.

Legislative requirements

The *Financial Accountability Act 2009* (the Act) and the *Financial and Performance Management Standard 2009* (the Standard) mandate agency legislative obligations:

- sections 79 and 80 of the Act deal with appropriations and preparation of financial statements for those departments impacted by MoG changes.
- sections 42 to 53 of the Standard detail the reporting requirements applicable to departments and statutory bodies. Attention is drawn to:
  - section 44 which deals with the preparation of financial statements of newly formed departments and statutory bodies
  - sections 47 and 48 which specifically relate to the preparation of final financial statements for abolished departments (section 47) and statutory bodies (section 48), and
  - section 53 which deals with the final report of an abolished department or statutory body.

Reporting obligations required under appropriate Australian Accounting Standards must be recognised by departments when dealing with MoG changes. The FRRs will assist in the identification and application of appropriate accounting standards.

Negotiation and recording

Treasury Financial Circulars are published to assist departments on processes for negotiating and recording the financial impact of MoG changes. Departments should liaise with their Treasury Analysts on issues relevant to MoG changes such as:

- negotiation of MoG transfers
- finalisation of negotiations and sign off

- Tridata impacts, and
- Governor in Council approval and publication in the Gazette.

Treasury has also released the *Guidelines for Machinery of Government (MOG) changes* which covers issues such as the effective date of MoG changes, Governor in Council approval for appropriation transfers, and other appropriation issues, as well as providing a MoG transfer sign-off form to facilitate the finalisation and documentation of negotiated MOG transfers.

Governance

The Queensland Audit Office has published *Good practice – Managing machinery of government changes* which may assist agencies in organisational and governance matters arising as a result of MoG changes.

The checklist provides guidance on:

- general governance and organisational issues, such as:
  - change management
  - governance matters such as delegations, financial and other systems, and financial policies and procedures, and
  - other corporate policies, plans, ownership of records, and stationery, signage and uniforms.
- financial management issues such as:
  - split of assets, liabilities, revenues and expenses
  - financial accounting matters, management reporting and chart of accounts
  - funding and budgets, and
  - shared service arrangements.

Recordkeeping

Queensland State Archives has published a number of resources to assist agencies deal with recordkeeping responsibilities following a MoG change, including a MoG change checklist.

Related resources

- Financial Reporting Requirements for Queensland Government Agencies, Queensland Treasury
  http://www.treasury.qld.gov.au/office/knowledge/docs/fin-reporting-req/index.shtml
- Good practice – Managing machinery of government changes, Queensland Audit Office
  https://www.qao.qld.gov.au/better_practice
- Guidelines for Machinery of Government (MOG) changes, Queensland Treasury
  https://www.treasury.qld.gov.au/publications-resources/guidelines-for-mog-changes/index.php
- Queensland State Archives
  http:/www.archives.qld.gov.au

Further information

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