



DEPARTMENT OF HEALTH

Internal Audit of: SES Budget Management

March 2018



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Timeline

Milestone	Dates
Entry Interview	11 December 2017
Approved Audit Plan	19 December 2017
Commence Fieldwork	20 December 2017
Completion of Fieldwork	28 February 2018
Exit Meeting	1 March 2018
Draft Report	8 March 2018
Final Report including Management Comments	15 March 2018
Final report provided to the Audit Committee	March 2018
Completion of the Audit Satisfaction Survey	March 2018

Sign-Off

I acknowledge the findings and recommendations enclosed in this report and undertake to have the agreed actions completed within the identified time frame.

.....
Charles Wann
A/g First Assistant Secretary
Financial Management Division
Department of Health


.....
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1. Executive Summary

1.1 Background

Senior Executive Service (SES) leaders in the Department are key to managing resources in their relevant Branches, Divisions and Groups.¹ To support that role, in July 2016, the Department implemented a centralised Finance Business Partner (FBP) model in response to recommendations from the functional efficiency review and to support the implementation of the Chief Operating Officer (COO) Group operating model. The main objective of the model is to provide customer-focused finance support to SES as they discharge their budget management responsibilities.

The Department's oversight structure at the start of this internal audit included a number of senior governance committees which had an oversight role to support the Department in carrying out its operations (including financial management) and achieving its strategic objectives. These included the Finance and Resources Committee (FRC), the Executive Committee (EC) and the Administered Program Board (APB). The key role of these committees was to make recommendations and provide advice to the Secretary and the Executives on strategic, financial and policy initiatives and issues to ensure effective decision making and adequate management of the Department's operations and performance.

In 2016-17 Financial Year (FY), the Department had budgeted its total expenditure to be \$62.79 billion, comprising \$61.97 billion of administered funds and \$829 million² of departmental funds. The Department's actual expenditure for the year was in excess of its planned budget by \$1.52 billion, including \$1.44 billion and \$83 million overspending in administered expenditure and departmental expenditure respectively.³

The objective of this internal audit was to examine the design and effectiveness of the Department's key controls for the management and oversight of its departmental and administered budgets. The audit also examined the mechanisms supporting accountability for management and oversight of budgets, including the FBP model.

1.2 Overall Assessment

The internal audit found weaknesses in the budget management and governance arrangements which prevent reliable identification of issues and management of financial resources across the Department consistent with allocations. These issues were borne out in FY 2016-17 and include: lack of clarity of roles, responsibilities and accountabilities of key players involved in managing administered and departmental budgets as well as limited direction from executive governance bodies; inadequacies in budget management reports and analysis; weaknesses in the effectiveness of the FBP model and variable understanding of budget management tools in the Department.

While a number of positive initiatives have been introduced since that financial year to mitigate these issues, the structures and arrangements are still not sufficiently mature to support relevant parts of the Department's management to effectively and confidently report and manage financial resources consistent with budget.

Awareness of the importance of budget management has heightened in this financial year however, roles, responsibilities and accountabilities for SES budget management are defined only at a superficial level and are not enforced. Further, SES do not consistently have the knowledge, tools or support to identify and respond to issues as they arise.

Finally, it is noted that since 2015-16, budget management has been largely undertaken in isolation of business plans and risk management, meaning that any decisions relating to budget performance may

¹ Australian Public Service Commission, *APS Senior Executive Service Work Level Standards 2012*, 3.

² Including Special Accounts for TGA, OGTR and NICNAS

³ Source: Department of Health 2016-17 Annual Report, Part 4: Financial Statements. Note that the departmental overspend includes unfunded depreciation and amortisation of \$21.8 million. Note that the administered overspend is largely driven by demand-driven programs over which the department has limited control over demand (refer Note 16 of the 2016-17 audited financial statements for further details).



have unintended consequences to risk or achievement of priorities in business plans.

The audit recommends that the Department embeds the improvements already commenced into operational processes and establish additional controls to reinforce the Department's budget management control framework.

1.3 Summary of Findings and Recommendations

The following is a summary of the key findings noted during this audit. The risk ratings associated with these findings reflect the assessment of consequence and likelihood of the related risk exposure of the finding using the Department's Risk Management Matrix and definitions included in **Attachment A**.

No.	Summary of Finding	Risk Rating
1	Lack of Clarity of Roles, Responsibilities and Accountabilities: There is a lack of clarity of roles, responsibilities and accountabilities of key players involved in the management of the Department's departmental and administered budgets, including consistency of approach and how roles interact and delineate.	High
2	Inadequacies in Reporting: There are weaknesses in the Department's budget management reports and analysis at the Branch and Divisional level which undermines the usefulness and reliability of these reports as a key control for the management and oversight of budgets.	High
3	Weaknesses in the Effectiveness of the FBP Model: Weaknesses noted in the service delivery of the FBP model limit the achievement of its main objectives.	Medium
4	Underutilisation of Budget Management Tools: There is variable understanding, and limited use and uptake of key tools for SES management of administered and departmental budgets.	Medium

The following three recommendations have been made to improve the budget management control framework over the intermediate and long term.

No.	Recommendation	Findings Addressed
1	Defining the Framework for Managing Budgets: The Department should clearly define the framework for managing budgets, including defining the objectives and what success looks like. Once completed, the Department should communicate the framework to all relevant stakeholders in budget management within the Department. As part of the budget management framework, the Department should: <ul style="list-style-type: none">Define roles, responsibilities and minimum standards of all players in budget management, including any involvement of section heads; and defining the FBP service offering.Finalise the structures and terms of reference of the senior governance committees that will provide oversight on budget and operations;Refine budget management tools and provide training to raise institutional awareness. The audit expects the completion of the Department's Financial Management Strategy to incorporate some of the above components.	Findings 1, 2, 3 and 4.



No.	Recommendation	Findings Addressed
2	<p>Improving Budget Monitoring and Linking Budget to Business Plans and Risks:</p> <p>The Department should establish (and instil within the SES and FBP of the Department) clear guidance to improve effectiveness of budget monitoring including:</p> <ul style="list-style-type: none">establish budget reporting standards, including minimum standards for forecasting principles, trend analysis, as well as establishing definitions and thresholds for budget variances and commentary; andlink forecasting to risks of not achieving planned activities, as well as linking budget, resources and expenditure to operational performance and achievement of outcomes. <p>In the first instance, this will be supported by linking Divisional and Branch business planning to budget analysis and risk identification.</p>	Finding 2.
3	<p>Strengthening Accountability and Escalation Mechanisms:</p> <p>The Department should strengthen and implement oversight mechanisms to support SES accountability for managing budgets, including monitoring of compliance. This should include:</p> <ul style="list-style-type: none">Regular discussions of budget management variance reports at the Executive Board (EB) and establishing mechanisms for monitoring over/underspending including follow-up on remedial action plans.CFO and responsible FBPs to continue holding accountability discussions on a regular basis with FASs and ASs on budget performance, and reporting outcomes to EB. These discussions should be based on a set of specific KPIs for financial management which feed into SES performance assessmentsEstablishing KPIs to empower FBPs to understand the business and activities of their assigned business unit through requesting formal feedback from business units on FBP performance and building these KPIs into FBP performance agreements.Formalising feedback mechanisms between the Finance Business Support (FBS) Branch and FBP clients as part of the FBP service delivery standards to gain feedback on the FBP service delivery and identify areas for improvement.	Findings 1 and 3.

1.4 Summary of Improvements to Budget Management in 2017-18

Improvement Area	Detail
Improving Contextual Understanding of the Department's Budget	Increased efforts by the Financial Management Division (FMD) to improve SES' contextual understanding of the Department's budget has allowed SES to understand the 'bigger picture' of the Department's budget and their shared responsibilities.
Increasing SES Awareness about Accountability and Responsibility over Budget Management	Embedding responsibility for effective management of budgets into SES performance agreements and revised SES Remuneration Criteria has increased SES awareness about their responsibility to closely manage their budgets.
Continuous Refinement of the FBP Model	The FBS looks to continuously incorporate lessons learnt to improve the FBP service delivery and has established an action plan for this purpose.
Improving System Functionalities	The launch of the Administered Reporting Improvement Project (ARIP) has improved TM1 functionality to suit the needs of administered budget reporting.



1.5 Management Comments

Management agrees with and accepts the commentary and recommendations in this report.

1.6 Restriction of Use

This report is intended solely for use by the Department of Health, and should not be distributed to any third party without the consent of Protiviti, which will not be unreasonably withheld. This document is not to be used for any other purpose, except as required by law, without our prior express consent.

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2. Background, Objective, Scope and Approach

2.1 Background

The Department of Health (the Department), as a non-corporate Commonwealth entity, is accountable to the Parliament and the Australian community to use public resources efficiently to achieve agreed results in accordance with the requirements of the *Commonwealth Resource Management Framework*. For the 2017-18 financial year (FY), the Health Portfolio is budgeted to spend \$87.9 billion on health and aged care (including both departmental and administered funds).⁴

Legislative Authority and Federal Guidance

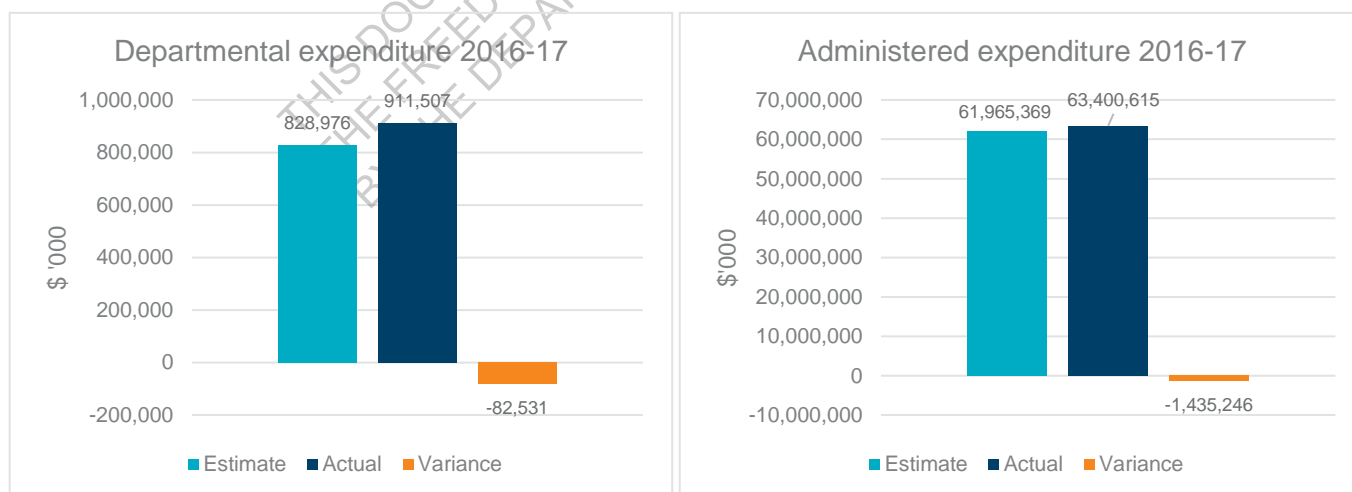
The *Public Governance, Performance and Accountability Act 2013* (PGPA Act) places a duty on Accountable Authorities of Commonwealth entities to govern the entity in a way that promotes the proper use and management of public resources and promotes the financial sustainability of the entity.⁵

Accountable Authorities are required to establish governance arrangements for their entity that clearly set out the roles, responsibilities and accountabilities of officials.⁶ These systems and processes must help officials to determine how decisions about the use or management of public resources will affect public resources generally. To promote the proper use and management of public resources, Accountable Authorities can, among other things, establish:

- decision-making processes for the proper use of public resources including robust decision-making and control processes for the expenditure of relevant money (for example, decision-making processes could be supported by requirements on the type of information that officials need to consider before making a spending decision); and
- appropriate oversight and reporting arrangements for activities and projects and to address the inappropriate use of resources by officials, including processes to ensure that all officials disclose material personal interests.

2016-17 Budget Results for the Department

In FY 2016-17, the Department had budgeted its total expenditure to be \$62.79 billion, comprising \$61.97 billion of administered funds and \$829 million⁷ of departmental funds. The Department's actual expenditure for the year was in excess of its planned budget by \$1.52 billion including \$1.44 billion and \$83 million overspending in administered expenditure and departmental expenditure respectively⁸.



⁴ Department of Health, *Corporate Plan 2017-18*, 13

⁵ *Public Governance, Performance and Accountability Act 2013* (Cth), s 15

⁶ Resource Management Guide (RMG) 200, [23]

⁷ Including Special Accounts for TGA, OGTR and NICNAS

⁸ Source: Department of Health 2016-17 Annual Report, Part 4: Financial Statements.



Budget Management in the Department

At the commencement of this internal audit, there were seven senior governance committees providing support to the Department in carrying out its operations and achieving its strategic priorities including three that had a direct role in budget management oversight. These included the FRC which was chaired by a Deputy Secretary, with members chosen from the SES cohort in the Department. The Committee had a role of making recommendations to the Secretary and the EC on strategic financial and security management policy initiatives and issues, and providing advice on the allocation of resources including budget adjustments.

In addition, the APB is an advisory subcommittee of the FRC created to assist the FRC and Executives by providing oversight of the Department's administered funds. The role of the APB is to improve financial understanding of all administered expenditure and to make recommendations to the FRC on the management of funding pressures and budget savings. The APB is chaired by the COO and membership comprised First Assistant Secretaries (FAS) with administered funding accountabilities.

In parallel, the EC role included providing strategic, whole-of-organisation advice to the Secretary and the Department's leaders to ensure effective decision-making, management and oversight of the Department's operations and performance. It is the key forum to guide cross-portfolio issues in the Department.

SES provide leadership and are key to delivering departmental programs, shaping public policy, implementing relevant compliance and managing resources in their relevant Branches, Divisions and Groups. SES in the Department are accountable for the overall management, oversight and adherence to their allocation of departmental and administered budgets with support from the FMD.

In July 2016, the Department implemented a centralised Finance Business Partner (FBP) model in response to recommendations from the functional efficiency review and also to support the implementation of the COO Group operating model. The main objective of the model is to provide customer-focused finance support to SES as they discharge their budget management responsibilities. The model is currently delivered by the Financial Business Support (FBS) Branch within FMD.

Features of Better Practice Budget Management

The following are common features of better practice budget management:

- Integrate internal budgeting into organisational planning.
- Align internal budgets with organisational risks and responsibilities.
- Integrate operational and capital budgeting.
- Harmonise budgeting and reporting.
- Engage stakeholders in internal budget processes.
- Effective oversight, review and communication.
- Monitoring and reporting against internal budgets, including:
 - reporting budget performance;
 - assisting managers to assess budget performance;
 - phase budgets to provide meaningful comparisons; and
 - analyse and explain budget variances.
- Periodically revise the internal budget.
- Forecasting to manage gaps between budget estimates and actual results.

2.2 Objective

The objective of the internal audit was to examine and provide advice on the design and operating effectiveness of the Department's key controls for the management and oversight of its departmental and administered budgets. The audit also examined the mechanisms supporting accountability for management and oversight of budgets, including the FBP model.



2.3 Scope

The scope of the internal audit included:

1. Assessing the adequacy of governance arrangements for the management of departmental and administered budgets in the Department, including:
 - roles, responsibilities and accountabilities of SES⁹ in managing budget allocations and forecasts;
 - effectiveness of supporting arrangements through the FBP model including the level of expertise, standardisation of processes, procedures and documentation; and
 - adequacy of issue management and escalation mechanisms including communication with executives and relevant budget monitoring committees and following up on decisions and agreed action.
2. Assessing the adequacy of processes and enabling tools used for budget monitoring and reporting in the Department including IT systems, frequency, and structure and distribution of budget monitoring reports.
3. Assessing the timeliness of budget monitoring, including identification and communication of budget variances and root causes and decisions made to making adjustments.

2.4 Scope Limitations

The scope of this audit did not include:

- review of budget allocation processes as the audit focused on the management of budgets after being allocated and approved;
- review of budgeting activities at the Balance Sheet or Cash Flow as the audit was focused on assessing the management of budgeting of the income statement;
- review of processes for managing and reporting on performance including the preparation of the Department's annual performance statements;
- assessing the effectiveness of the FBS Branch including assessment of performance of individual FBPs as the audit was limited to assessing the effectiveness of the FBP service delivery model in supporting SES to discharge their budget management responsibilities;
- the provision of any legal or financial advice;
- conduct any form of financial statement auditing of final budget outcomes; and
- reviewing controls for portfolio agencies or consultation with external stakeholders.

The assessments made during this internal audit have been provided in good faith and in the belief that such statements and opinions are not false or misleading. Due to the limited duration of the internal audit, Protiviti has relied on information that was provided by the Department. Protiviti does not express an opinion as to whether the information supplied is accurate and no warranty of accuracy or reliability will be given. Furthermore, we have not implied and it should not be construed that we have verified the information provided to us, or that our enquiries could reveal any matter that a more extensive examination might disclose.

The Department is responsible for maintaining an effective internal control structure. The purpose of the internal audit was to assist management in discharging this obligation. Due to the inherent limitations in any internal control structure, it is possible that errors or irregularities might have occurred and have not been detected. Further, the overall control environment within which the reviewed control procedures operate has not been audited.

⁹ For the purpose of this audit, the focus of SES responsibilities and accountabilities focussed on the FAS and AS level, given their more direct influence over budgeting, forecasting and financial operations in Branches and Divisions. Executive involvement (Deputy Secretaries and the Secretary) is canvassed separately.



Please note that an internal audit is not designed to detect all weaknesses in control procedures as the audit is not performed continuously throughout the period and the tests performed were conducted on a sample basis. Any projection of the evaluation of the control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.

Considerable professional judgement is required in determining the overall assessment. Accordingly, others could evaluate the results differently and draw different conclusions.

2.5 Risks Addressed

The internal audit was designed to address the following enterprise level risks:

- failure to learn through measuring and evaluating policies, programs and service outcomes; and
- governance arrangements do not support the provision of timely, accurate and robust advice.

2.6 Approach

In conducting this internal audit we completed the following activities:

- held discussions with key stakeholders to understand and document key risks and business processes related to internal budget management including where previous issues have occurred;
- examined the Department's documented policies and procedures and other relevant information related to the management of the departmental and administered budget. This included documented process maps; roles and responsibilities matrices, risk assessments, and reporting and monitoring mechanisms;
- examined available previous reports / advice related to internal budget management, including the recently completed 'FBS Branch health check' report and related action plan;
- selected 6 case studies from branches across the Department and conducting discussions with relevant SES and FBPs and reviewing available documentation to gain an understanding of known risks and assess the effectiveness of budget management monitoring processes and reporting controls and further understand root cause(s) for FY 2016-17 budget variances;
- compared the Department's internal budget management practices against relevant RMGs and better practices, including ANAO's former better practice guide on *Developing and Managing Internal Budgets*
- used the case studies and compared against better practice to identify risks, control gaps and continuous improvement opportunities.



3. Improvements to Budget Management in FY 2017-18

Throughout the audit, we identified the following business processes and budget management controls that had been improved in 2017-18, in part in response to the overspend issues that occurred in 2016-17. These are positive developments that position future improvements to budget management.

3.1 Improving Contextual Understanding of the Department's Budget

Increased efforts by the FMD to improve SES cohort's contextual understanding of the Department's overall budget has allowed SES to understand the 'bigger picture' of the Department's budget constraints and their shared responsibilities. We received positive feedback from the sample of Assistant Secretaries (ASs) we consulted on the usefulness of the last two SES-wide presentations hosted by the FMD Division Head in increasing transparency and understanding of the Department's budget.

3.2 Increasing SES Awareness about Budget Accountability and Responsibility

Embedding responsibility for effective management of budgets into SES performance agreements and revised SES Remuneration Criteria has increased SES focus on their responsibility to manage their budgets. Our consultations indicate that in previous years, the requirement to actively manage and keep within budgets was not a mandatory component in SES performance agreements. Further, there was limited articulation of the requirement for SES to stay within their allocated budgets, other than in a letter from the former Secretary which was circulated to all FASs in July 2017. Formalising budget management as a key component of SES performance and remuneration criteria is positive practice to strengthened understanding of SES accountability and responsibility over their budgets.

3.3 Continuous Refinement of the FBP Model

The FBS Branch has been recently working towards incorporating lessons learnt to improve the service delivery of the FBP model. The Branch has recently completed a 'health check' review based on consultations with all the FAS cohort. This exercise improved the understanding of FBP clients' needs and resulted in preparing a detailed action plan. This plan includes immediate and longer term actions to respond to feedback received during this exercise, and included some refinements in the internal structure and composition of the teams. Further, there have been recent visits by the acting AS of the FBS Branch to Branches and Divisions across the Department to improve communication and refine the service delivery model.

3.4 Improving System Functionalities

The recently introduced ARIP tool has built upon the TM1 functionality to suit the needs of administered budget reporting. ARIP was planned and implemented with a governing ARIP Board, and was built with the intention to eliminate the need for budget managers and FBP to keep shadow spreadsheets and reports to track the administered budget.



4. Findings

In this report, we have reported all findings, and then proposed a suite of recommendations (in the next section of the report) to address the findings and improve the budget management arrangements.

4.1 Finding 1: Lack of Clarity of Roles, Responsibilities and Accountabilities

There is a lack of clarity of roles, responsibilities and accountabilities of key players involved in the management of the Department's departmental and administered budgets, including consistency of approach and how roles interact and delineate. This means that budgets are being managed inconsistently, and in some cases ineffectively, across business units in the Department.

Discussion

The budget management process in the Department involves a number of players including ASs, FASs, Deputy Secretaries (DEPSECs) and the FMD, encompassing FBPs, Finance Branch and Budget Branch, in addition to the oversight role of governance committees (which formerly included FRC and EC).

While SES ownership over their allocated budget seems to have improved due to new measures such as the revised SES Remuneration Criteria, the understanding of budget management roles and responsibilities including tasks and processes remains limited. In addition, there is a lack of clarity of the roles, responsibilities and accountabilities of all other players in budget management processes.

Better practice budgeting disciplines generally feature operational and financial managers with sufficient skills and awareness to manage the financial resources under their control. Further there should be clear communication of roles and responsibilities including timelines for delivery, sign-off responsibilities and escalation mechanisms, is a key mechanism to support the effective management of internal budgets. The following are key observations in this regard.

4.1.1 Lack of Guidance on SES Management Roles and Responsibilities

There is a lack of clarity over how AS and FAS budget management responsibilities should be managed and how roles should be carried out. SES budget management requirements, expectations and tasks are not clearly articulated in any guidelines or financial training.

The audit identified limited requirements for SES to review and understand their budget forecasts, variances and budget phasings. Further, consultation with ASs showed that levels of ASs engagement over departmental budgets varied, with some ASs having no involvement over their branch's departmental budget, instead being wholly controlled by the FAS. This indicates the need for further clarity around FAS's responsibilities over Divisional and Branch budgets, and AS responsibilities over branch budgets, and establishing communication protocols for management activities such as budget revisions.

There was limited documented requirements or understanding of the need for SES to approve or sign-off on reports. Review of Divisional "smiley" reports also showed that FAS approval of budget reports to the FMD were inconsistently practised, with four out of 18 reports submitted to the FMD that were not approved by the FAS or had no indication of whether or not it was approved. Our understanding is that in some cases additional approvals may be solicited through email or phone conversations by the FMD. There was also lack of understanding of AS's approval requirements for reports to be consolidated for FAS's approval. In addition administered reports had no approval mechanisms for FBP reporting to the FMD through ARIP.

Further, the *Internal Departmental Budget Guide 2016* states that budgets must be prepared at section levels, indicating that section heads may need to have budget creation and monitoring responsibilities for sections. Anecdotal evidence suggests that this is not occurring in many Divisions of the Department. The roles and responsibilities of section heads is an area for consideration in the Department's budget management framework.

4.1.2 Lack of Clarity for SES on FBP Roles and Service Delivery

In the sample of AS interviewed, we identified that AS did not clearly understand the service offering provided by FBPs, or how their role delineates from other finance and budget officers or SES roles. FBS Branch have developed an FBP 'responsibilities and accountabilities' matrix which states the



responsibilities and accountabilities of FBPs, Finance Branch and Budget Branch, and responsibilities of group executives (DEPSECs, FASs and ASs) in supporting the FBP model. However, our meetings with ASs indicated that the roles, responsibilities and structure of FBP were not clearly explained to ASs. Similarly, our review of the internal report on the 'FBP Health Check' indicated that FASs felt that there was a need to clearly establish and promote agreed roles, responsibilities and practices for the FBP team and Divisional Executives, and the FBP model architecture. The lack of clear communication of the FBP service offering may mean assumptions are made on what can be expected or what cannot be provided through FBPs. Lack of understanding of FBP roles and purpose may be a contributor to variability in levels of consultation and engagement with FBPs and confusion over the roles of various FMD players as liaisons to SES budget management.

4.1.3 Limited Direction and Action from Governance Bodies

There was limited evidence of clear direction or guidance from governance bodies, including the EC and the FRC on responding to budget variances including action plans or follow-up on alerts. The *Public Governance, Performance and Accountability Act (2013)* mandates that the Chief Executive is ultimately responsible for effective management of financial affairs within their organisation and one approach to oversight of internal budget processes is through establishment of a budget committee. The Terms of Reference for the Department's FRC and EC mandated an advisory role to provide strategic advice to the Secretary and leaders in the Department. However, while budget concerns or substantial variances were reported in a timely manner through consolidated reports to both the EC and FRC, minutes of meetings showed that there was limited advice or action from these committees to enforcing accountability on reported variances and to establish or follow-up on mitigation measures or action plans.

It is our understanding that the Department is currently undergoing a reform of its governance committee structure, and that a new EB has been established with the intention of consolidating these two committees and strengthening executive oversight over the Department's performance including clear mandate for the monitoring and addressing of departmental performance and risks. This is a positive step for the Department's budget management oversight, as limited direction and enforcement from upper management leads to the risk of ongoing inaction in response to known and projected budget overruns or missed opportunities in the case of budget underruns.

Risk Exposure

Poor definition of budget management roles and responsibilities increases the risk of inconsistent or ineffective budget management practices and confusion over budget responsibilities and tasks. This may result in poor management of resources and untimely or inadequate decision-making in response to budget variances.

Risk 1 Rating	Consequence	Likelihood
High	Major	Likely

4.2 Finding 2: Inadequacies in Reporting

There are weaknesses in the Department's budget management reports and analysis at the Branch and Divisional level which undermines the usefulness and reliability of these reports as a key control for the management and oversight of budgets.

Discussion

SES require transparent, reliable and timely financial information to make informed decisions on managing their budget. The Department's monthly reporting regime provides for timely financial information, however, budget reporting processes and content should be improved to strengthen transparency, reliability and usefulness of financial information to SESs and Executives. A number of weaknesses in the Department's budget management reporting at the Branch and Divisional level, as compared against better practice and the Department's internal procedures and needs are discussed below.



4.2.1 Data Inaccuracies in Budget Monitoring Reports at the Division and Branch Level

Our consultations with several stakeholders, including ASs, FBPs and Finance Branch officers indicated that budget and actuals figures sometimes change between months without adequate communication or explanation of the changes.¹⁰ This results in conflicting messages on how Branches or Divisions are tracking against budget. Review of branch reports also showed significant variances in forecasts between months. For example, one branch had a forecasted departmental underspend of 2% in December 2016 and a forecasted overspend of 22% in March 2017 without accompanying commentary or explanations.

Further, SES consulted during the audit advised that data would not always accurately reflect business operations. Changing information in TM1 could be due to several reasons including uncommunicated changes in budget figures, incorrect coding of expenses, or inaccurate budget phasing. These unexplained (or perceived) inconsistencies and inaccuracies in reports have led to a lack of confidence in data provided to SES, resulting in SES running parallel systems and spreadsheets to manage their budgets. In some cases, due to the complex nature of administered expenses, SES have input data directly into TM1 themselves and replicated the work of FBPs, in order to regain confidence in the reliability of data.

Our audit did not include a comprehensive audit of accuracy of financial reports. It is the responsibility of FBPs to both produce reliable and accurate reports, and to ensure that users of those reports have confidence in their veracity. In addition, the role of the FBP is to produce value-add advice to their internal clients based on those financial reports.

4.2.2 Opportunity to Improve Level of Detail for Administered Reports

In the case of administered budgets, budget and expenditure are reported at the Priority level rather than against Divisions and Branches. This leads to difficulty for managers (who are responsible for the expenditure in their business unit, which may include only part of a Priority, or may include multiple Priorities) in managing and tracking reasons for administered budget to actual and controllable variances. Further, better practice suggests that effective budget monitoring requires budget managers to be provided with relevant, timely and accurate information appropriate to their level of responsibility, and budget managers should only be held accountable for budgets that they control. Priority-level reporting leads to the risk that accountability and expenditure over shared administered buckets cannot be traced, and SES are held accountable for expenditure by other budget managers under the same pool of administered budget.

4.2.3 No Clear Standards for Variance Analysis and Commentary

Better practice budget management suggests that organisations have internal guidance to help ensure a consistent approach to analysing and explaining budget variances. However, the Department has limited standards and business rules that are used for variance escalation and analytical content.

For example, of the Branch reports reviewed, there were limited instances where variances were explained in reporting commentary, leading to a lack of information for AS to understand the root causes of why variances were occurring.

In addition, for departmental budget reports at Divisional level sent to the Finance Branch, there were no 'thresholds' for when variances had to be explained by the FBP and confirmed by the budget owner. While the administered budget had threshold rules for when Program and Priority budget variances had to be explained by FBP, these rules were not always followed.

Further, there were no clear business rules used by the Finance Branch for the selection of variances that would have to be highlighted in consolidated reports for the EC and FRC, leading to a potential lack of coverage or thorough prioritisation of key issues.

It is our understanding that Divisions vary in size from <\$1million to \$100million for departmental budget and that administered budget programs vary significantly from \$30 billion (Medicare Benefits Scheme) to smaller grant programs so providing hard variance thresholds may not be practical. However, without early

¹⁰ It is noted that there are instances where previous reporting changes due to structure changes and staff movements and these are made retrospectively. The audit is advised that much work has been done by Finance branch to raise awareness of the implications of backdating. Consultations suggest this remains an area of some confusion for some SES officers.



identification of actual or potential budget variances at a Section and Branch level, SES will not be able to make informed decisions to actively manage risks early and to be proactive. At a minimum, there should be centralised guidance on what constitutes a significant variance that requires commentary expressed as a percentage of the allocation or a monetary value at a Section, Branch and Division level.

4.2.4 Forecasting and Phasing is Not Transparent or Reviewed

Monthly phasings that are created in accordance with foreseeable patterns of expenditure and a driver-based approach to forecasting are key better practice budgeting concepts. Further, better practice highlights the importance of reports to incorporate out-year forward estimates with an examination of future risks and opportunities. However, branch reports on departmental and administered budgets, and Divisional 'smiley reports' that were reviewed did not include explanation of how budget phasing and forecasts were created, including information on the underlying principles for the projections used.

Our review indicated that there is no clear guidance for the preparation of forecasts or close review of budget forecasting provided in Branch or Divisional reports. For example, most reports did not show or discuss future risks, projects or disruptions to year-out budget and activities and outcomes. Consultation with ASs confirmed that forecasting data and information from FBP only provided figures and the underlying basis or explanations to complement these figures were limited. The lack of rationalisation and transparency over phasing and reported forecasts undermines their accuracy and reliability in projecting budget performance.

4.2.5 Limited Trend Analysis

Trend analysis, referring to the comparative analysis of an organisation's financial information over time to identify patterns, is an analytical tool that can provide important information to budget managers. For example, reporting showing comparative results for the same period in previous years can assist with the identification of trends that may affect budgets and forecasts. For example, establishing staffing trends may be valuable for managing and forecasting departmental budgets.

While some trend analysis is prepared for the Executive, our review of documentation identified that budget management reports at all levels included limited trend analysis. For example, Divisional reports to the Finance Branch often did not compare financial performance from previous months to show whether financial performance was improving or worsening.

It is our understanding that the main reason for not using trend analysis has been due to the significant number of structure changes throughout the year/s including significant machinery-of-Government changes in recent years which may impact comparatives and distort information at a whole of department level. However, it may now be time to reintroduce trend analysis in budget management reports at all levels.

4.2.6 No Linkage of Budgets to Performance Information

To provide an analysis of budget expenditure against goals and targets, better practice suggests that it is essential for financial information to be complemented by non-financial performance indicators, such as delivery of the businesses' work and projects. It is our understanding that since 2015-16 budget management has been undertaken largely in isolation of business plans and risk management.

The reports reviewed as part of this audit showed that no links are made between budget and operational information, delivery of assigned work, or achievement of outcomes. This leads to the inability to track budget expenditure and use against the Department and its businesses completing their assigned work and achieving its purpose.

Risk Exposure

Lack of robust reporting standards and comprehensive financial (and related non-financial) information undermines the value of finance reports as a key control in budget management and oversight. Ineffective reporting increases the risk of inaccurate understanding of budget positions by the Department's leadership, and SES making financially-uninformed management decisions.



Risk 2 Rating	Consequence	Likelihood
High	Major	Possible

4.3 Finding 3: Weaknesses in Effectiveness of the FBP Model

Weaknesses were noted in the delivery of the FBP model, which limits the achievement of its objectives.

Discussion

The FBP model was developed in the Department in July 2016, as part of broader work in response to recommendations arising from the functional efficiency review and to support the COO model. The intention of the FBP model was to establish a centralised team of accounting experts to deliver consistent financial management support to the Department's SES across Branches and Divisions. FBP Team structures are largely established at the Group level, with a Director FBP heading each team. Each FBP team is expected to be a single point of contact for Group Executive on financial management matters, and teams have assigned FBPs for each Division to work with the relevant FAS and ASs. The main objectives of the model and FBP role are listed below (with emphasis added for objectives that relate to budget management):

- Provide strategic and operational financial and *budget advice* to Group management and the CFO;
- Support the preparation of timely and accurate financial and *budget information and analysis* across departmental, administered and capital;
- Provide timely recommendations regarding *financial forecasts and likely end of financial year financial outcomes* for Departmental, Administered, Capital and Special Accounts;
- Be the Group's first point of contact back into Financial Management Division (both Finance Branch and Budget Branch);
- Maintain professional working relationships;
- Identify and develop opportunities to *improve financial and budget management and business processes*;
- *Maintain priority level and cost centre budgets including the preparation of monthly phasings*;
- *Prepare budgets and forecasts* and develop financial input into business planning;
- Undertake charging and costing recovery reviews as appropriate;
- Provide financial oversight for projects;
- Provide advice and assistance in relation to funds availability;
- Initial point of advice on Purchase Orders, Commitments, etc;
- Collect and assure Group financial information required for monthly statutory reporting, asset management, taxation, and audit matters, etc;
- Ensure compliance and internal controls frameworks are followed, including reporting to CFO on compliance matters;
- Provide financial input into briefs as required for Executive Committee, Secretary, Managers and other stakeholders; and
- Gather information for audit findings as required for CFO, Executive Committee, Audit Committee and ANAO's consideration and resolution.

While this internal audit has not undertaken an evaluation of the design of the FBP model, we note that there are examples of such models achieving outcomes such as those outlined above in other organisations. The results of this internal audit however, has indicated some weaknesses in the service delivery of the FBP model which limits the achievement of these objectives.



4.3.1 Inconsistency in Service Delivery to Clients (SES)

We noted that there are widespread inconsistencies in the service delivered by FBP to FASs and ASs. Review of Branch reports showed that there were inconsistencies in the number and type of reports used to consult with ASs, and most reports did not have commentary to explain potential causes of variances or corrective action to mitigate future overruns.

Our consultations with ASs also showed that interactions with FBPs was inconsistent, with some ASs meeting with their FBPs once a month, and some had never met with their FBPs. Review of Divisional 'smiley reports' also showed that the quality of mandatory variance commentary was inconsistent, with some FBP providing limited analysis on the causes of overspends or underspends and ongoing mitigating action, while others provided more detailed analysis and commentary on actual and forecasted figures.

Our review and consultation with a sample of FBPs revealed that the root cause of these issues is largely the lack of minimum standards or guidance provided to them. The lack of standardised guidelines for FBP services such as: frequency of meetings with clients; tools and types of reports to use; content of reports; as well as lack of formalised feedback from clients, definition of performance criteria or escalation mechanisms within the FBP structure, is a potential cause of FBP confusion around their responsibilities, and inconsistent or unsatisfactory service delivery to clients.

4.3.2 Lack of FBP's Familiarisation with their Client's Business

FBPs have variable levels of understanding of the complexities and operations of their client businesses, leading to limited client satisfaction with their service. The results of the recent FBP health check and our consultation with ASs and FBPs indicate varied satisfaction with the role of the FBPs in understanding programs and activities at a section or cost centre level to effectively manage budgets, analyse variances, and provide meaningful financial advice.

The discussions revealed that some ASs and FASs were satisfied with the pro-activeness of their FBPs to gain knowledge and understanding of their business, while others suggested that some FBPs were not actively engaging with their business or understanding their priorities and operations.

While FBPs have relevant accounting qualifications and experience, the effective engagement of FBPs with their assigned clients has largely relied on the proactivity of individual FBPs instead of a standard approach and minimum performance criteria that requires FBPs to actively seek to learn and understand the business and activities of their assigned clients as part of their work plan.

Risk Exposure

Lack of minimum standards and guidance to FBPs, and inconsistent engagement with clients increases the risk of limited SES engagement with their FBP and undermining the role of FBPs as a trusted advisor. This may also result in waste of the Department's resources and poor budget management decision-making.

Risk 3 Rating	Consequence	Likelihood
Medium	Moderate	Possible

4.4 Finding 4: Underutilisation of Budget Management Tools

There is variable understanding and limited use and uptake of key tools for SES management of administered and departmental budgets.

Discussion

Budget management tools such as the TM1 (which houses ARIP and the departmental forecasting and budgeting (FAB) system) and online interactive dashboards are among the Department's key tools that SES and FBP can use to manage departmental and administered budgets. However, there is limited knowledge, use and uptake of these tools, undermining their effectiveness as tools for SES budget management.



4.4.1 Variable Understanding of TM1 (ARIP and FAB) Functionality

Better practice suggests that providing access to user-friendly systems and tools allows budget managers to easily retrieve data, analyse drivers and model scenarios in developing budgets.

Our consultations with a sample of AS indicated that there was variable understanding of the budget management tools such as TM1 and its functionalities. Certain functionality such as modelling were also unknown to FBPs, limiting the potential use of the TM1 system to its full capabilities as an analytical tool to inform budget management decisions. Lack of knowledge and training about the use and functionality of institutional tools such as TM1 (including ARIP and FAB) may also lead to the use of parallel databases and spreadsheets.

4.4.2 Limited Use and Uptake of Available Interactive Dashboard Tools

The Human Resources 'Health Check' Dashboard and Executive Finance Dashboard provide HR-related and budget-related figures for the Department in an interactive intranet-based website.

Our review of user-analysis data for these dashboards and consultations with AS indicate that the uptake of these tools has been low, despite monthly reminders being sent out via email to all SES groups. Feedback received from ASs indicate their inability to identify details on the variances and the value add relative to other FBP and FMD reports. This may reflect ability to use and interpret the dashboards, as much as the effectiveness of the tools themselves.

The Department may benefit from an evaluation to assess the information included in these tools/Dashboards and their value-add to the SES and Executives.

Risk Exposure

Limited knowledge and use of the Department's budget management systems and tools limits adequate monitoring and management of budget including analysis of variances and/or implications. This may cause SES to make uninformed budget management decisions. This also results in wasting limited resources in an attempt to duplicate budget management data into parallel systems and undermines major investments and resources allocated by the Department to develop its central system and tools.

Risk 4 Rating	Consequence	Likelihood
Medium	Minor	Possible



5. Recommendations

The following three recommendations are made in response to the findings noted in this audit.

5.1 Recommendation 1: Defining the Framework for Managing Budgets

Recommendation 1	
Findings Addressed	Findings 1, 2, 3 and 4.
<p>The Department should clearly define the framework for managing budgets, including defining the objectives and what success looks like. Once completed, the Department should communicate the framework to all relevant stakeholders in budget management within the Department.</p> <p>As part of the budget management framework, the Department should:</p> <ul style="list-style-type: none">▪ Define roles, responsibilities and minimum standards of all players in budget management, including any involvement of section heads; and defining the FBP service offering.▪ Finalise the structures and terms of reference of the senior governance committees that will provide oversight on budget and operations.▪ Refine budget management tools and provide training to raise institutional awareness. <p>The audit expects the completion of the Department's Financial Management Strategy to incorporate some of the above components.</p>	
Management Comments	
The recommendation is agreed. Financial Management Division will work to update the framework for managing budgets.	
Accountable Position	Agreed Completion Date
Chief Financial Officer Assistant Secretary - FBS	30 June 2018

Assurance

The following will provide assurance that the recommendation has been implemented:

- documented budget management framework, including roles and responsibilities of key players;
- terms of reference for the EB; and
- results of the review of the functionality and usefulness of budget management tools.



5.2 Recommendation 2: Improving Budget Monitoring and Linking Budget Management to Business Plans and Risks

Recommendation 2	
Findings Addressed	Finding 2.
<p>The Department should establish (and instil within the SES and FBP of the Department) clear guidance to improve effectiveness of budget monitoring including:</p> <ul style="list-style-type: none">▪ establish budget reporting standards, including minimum standards for forecasting principles, trend analysis, as well as establishing definitions and thresholds for budget variances and commentary; and▪ link forecasting to risks of not achieving planned activities, as well as linking budget, resources and expenditure to operational performance and achievement of outcomes. <p>In the first instance, this will be supported by linking Divisional and Branch business planning to budget analysis and risk identification.</p>	
Management Comments	
The recommendation is agreed.	
Accountable Position	Agreed Completion Date
Assistant Secretary – FBS Assistant Secretary – Corporate Assurance Branch, Legal and Assurance Division	30 June 2018

Assurance

The following will provide assurance that the recommendation has been implemented:

- Documented guidelines for reporting standards and budget monitoring

5.3 Recommendation 3: Strengthening Accountability and Escalation Mechanisms

Recommendation 3	
Findings Addressed	Findings 1 and 3.
<p>The Department should strengthen and implement oversight mechanisms to support SES accountability for managing budgets, including monitoring of compliance. This should include:</p> <ul style="list-style-type: none">▪ Regular discussions of budget management variance reports at the EB and establishing mechanisms for monitoring over/underspending including follow-up on remedial action plans.▪ CFO and responsible FBPs to continue holding accountability discussions on a regular basis with FASs and ASs on budget performance, and reporting outcomes of these to EB. These discussions should be based on a set of specific KPIs for financial management which feed into SES performance assessments.▪ Establishing KPIs to empower FBPs to understand the business and activities of their assigned business unit through requesting formal feedback from business units on FBP performance and building these KPIs into FBP performance agreements.▪ Formalising feedback mechanisms between the FBS Branch and FBP clients as part of the FBP service delivery standards to gain feedback on the FBP service delivery and identify areas for improvement.	



Recommendation 3

Management Comments

The recommendation is agreed. The EB also receives variance reports and cost pressures for departmental and administered funding to assist discussions to manage financial outcomes and CFO conducts regular meetings with FASs in relation to budget performance

Accountable Position

Chief Financial Officer
Assistant Secretary – FBS

Agreed Completion Date

30 June 2018

Assurance

The following will provide assurance that the recommendation has been implemented:

- Terms of reference for relevant governance committees;
- Standard set of Financial Management KPIs to measure SES Budget Management performance;
- FBP service delivery strategy and FBP performance agreements, including KPIs.
- Update to FBP Action Plan including a separate action on the process for conducting surveys to measure performance of FBPs.

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BY THE DEPARTMENT OF HEALTH



Attachment A: Risk Rating Definitions

This internal audit report includes a range of findings and observations. The risk exposure of these findings and observations have been identified based on the internal audit work performed. A risk rating associated with the findings has been determined based on an assessment of the consequence and likelihood of the related risk exposure of the finding. We have used the Department Risk Assessment Matrix at **Diagram 1**.

Opportunities have been identified to address each finding / observation. **Diagram 2** provides an outline of the expected management response to, and monitoring of, recommendations. This has also been taken from the Department's Risk Management Framework.

Diagram 1: Risk Assessment Matrix

Australian Government Department of Health			RISK ASSESSMENT MATRIX				
Date Approved:			Likelihood				
General description of Consequences			Rare	Unlikely	Possible	Likely	Almost Certain
			Exceptional circumstances only	Not expected to occur	Could occur at some time	Will probably occur in most circumstances	Expected in most circumstances
Consequence	Would stop achievement of functional goals/objectives	Severe	High	High	Extreme	Extreme	Extreme
	Would threaten functional goals/objective(s)	Major	Medium	Medium	High	High	Extreme
	Requires significant adjustment to overall function to achieve objective(s)	Moderate	Medium	Medium	Medium	High	High
	Would threaten an element of the function and would require some adjustment to achieve objective(s)	Minor	Low	Medium	Medium	Medium	High
	Lower consequence to achievement of objectives.	Insignificant	Low	Low	Low	Medium	Medium

Diagram 2: Risk Tolerance Table

Rating	Risk Tolerance Table – Action Required
Extreme	Must be given immediate senior management attention. Risk assessment and approved plan, including treatments, must be undertaken.
High	Must have considerable management attention to reduce risk to as low as reasonably possible. Risk assessment and approved plan, including treatments, must be undertaken.
Medium	Risk should be managed and monitored. Risk assessment and approved plan required. If controls are working effectively then additional treatments are optional.
Low	Risk should be managed and risk and controls monitored.