



## Response to Questions on Notice

### JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Inquiry into Efficiency and Effectiveness: Inquiry into Auditor-General's Reports 25, 29, 38, 42, 44, 45 and 51 (2018–19)

**Australian National Audit Office**

#### **GENERAL COMMENTS**

**Nil**

#### **SPECIFIC QUESTIONS ON NOTICE**

##### **Question:**

The following questions were put on notice by Ms Lucy Wicks MP, Chair and relate to Auditor-General Report No.38 of 2018–2019, *Application of cost recovery principles*

1. What was the rationale behind the ANAO selecting the Australian Maritime Safety Authority (AMSA), the Department of Agriculture and Water Resources and the Department of Health for the Therapeutic Goods Administration for this audit? Why were they chosen over other entities?
2. What does efficiency and effectiveness look like in relation to cost recovery?
3. The ANAO states that 'AMSA, Agriculture and Health have not fully complied with key requirements of the Cost Recovery Guidelines, particularly those relating to Cost Recovery Implementation Statements, with Agriculture and AMSA not updating these at least annually as required.' How can transparency and accountability be achieved in departments in a way that makes the process more efficient for departments?
4. The report states that 'each entity regularly engages with stakeholders on cost recovery through industry constative committees, but none documented their Cost Recovery Engagement Strategies' – how could the process of documenting cost recovery engagement strategies enhance the efficiency or effectiveness of each departments cost recovery arrangements?
5. The ANAO has stated 'each [entity] has established effective cost recovery governance and accountability arrangements.' Can you explain why these are effective? Could the framework of cost recovery governance and accountability arrangements be transferred to assist with the transparency and accountability arrangements within other departments?
6. With regards to the AMSA's response – they indicated that a self-assessment had already begun with the Audit findings mirroring a large extent of what they had already identified.
  - a. When did this assessment occur?
  - b. Was the ANAO aware that this assessment had occurred before their audit was undertaken?
7. Could the ANAO explain why they would undertake an audit on AMSA when self-assessment was already underway/had already occurred?

8. The report stated that the audit was completed at a cost of approximately \$560,000 with 7 staff members – does the ANAO believe that this is an effective use of funds and resources? If so, why?

The following questions were put on notice by Mr Julian Hill MP, Deputy Chair and relate to Auditor-General Report No. 25 of 2018–2019, *Efficiency of the Processing of Applications for Citizenship by Conferral*.

9. During the audit of Home affairs did any data or findings result in requiring further investigations that varied from the proposed methodology
  - a. If so could you provide the committee with details?
10. Overall how would you assess the departments efficiency of the Processing of Applications for Citizenship by conferral against previous years?
11. Has the department provided sufficient information and evidence to support its response of not accepting recommendation no. 1?
  - a. If not, could you elaborate on what information would be needed to supports its response?

The following questions were put on notice by Mr Julian Hill MP, Deputy Chair and relate to Auditor-General Report No. 29 of 2018–2019, *Efficiency of the Investigation of Transport Accidents and Safety Occurrences*

12. Would you agree with the bureau's approach to Recommendation no.2 and do you think this will effectively resolve the issue?

The following questions were put on notice by Mr Julian Hill MP, Deputy Chair and relate to Auditor-General Report No. 38 of 2018–2019, *Application of Cost Recovery Principles*

13. Has the audit uncovered any concerning amounts of over-recovery or under-recovery from any of the departments, if so, was any further investigating required?
  - a. What range of over and under recovery (per cent) is considered to be acceptable?
  - b. What processes are in place to ensure adequate levels are recovered?

The following questions were put on notice by Mr Julian Hill MP, Deputy Chair and relate to Auditor-General Report No. 45 of 2018–2019, *Coordination and Targeting of Domestic Violence Funding and Actions*

14. ANAO found that the department does not publicly report on the extent to which outcomes of the National Plan are being achieved, with the exception of the draft 2017-18 report (yet to be released at time of this report)
  - a. Would it be helpful for the department to publish its achievement and outcomes regarding the national plan? If not, why not?
  - b. What benefits would there be for the department in doing so?

## ANAO Responses

1. As outlined in the Committee Hansard of 15 November 2019:

*Ms Rauter: ... in this particular case, it was a multi-entity audit—we look obviously firstly at which agencies and departments have a cost recovery element to their business or are fully cost recovered. We like to get a selection of different types of entities when we do multi-entity audits. We also look at past or ongoing audit activity that's otherwise going on in that agency or that portfolio, to make sure that we're getting a broad spread and we're not putting too much impact on those particular agencies by running too many audits at once or concurrent audits. Those agencies are selected because we hadn't looked for some time at their cost recovery activities, and there wasn't other activity going on at that time.*

*Mr Morris: We also talked to the Department of Finance about which types of agencies it might be useful to investigate that might raise issues of interest more broadly, so we did that as part of this audit.*

In addition to this, the ANAO also sought a mix of non-corporate and corporate entities, the latter of which included AMSA.

The three audited entities were selected over other potential entities in consideration of the factors outlined above.

2. Efficiency and effectiveness, together, are one of three cost recovery principles outlined in the *Cost Recovery Guidelines*.<sup>1</sup> Paragraphs 24 and 25 of the *Cost Recovery Guidelines* explain this principle.

*24. Efficiency and effectiveness in government involve making the proper use of available resources (people, money and other supplies) to achieve government policy outcomes. Government activities should meet quantity, quality and other targets, be undertaken at minimum cost, and be conducted in accordance with applicable policy and legislative requirements.*

*25. For a cost recovered activity, efficiency also relates to whether it is efficient to provide the activity on a cost recovery basis (i.e. the costs of administering cost recovery should be proportional to the charges for and potential revenue from the activity). This requires a balance between developing a more precise, but more complex and hence more expensive costing model, and developing a simpler and less expensive, but less precise, costing model. Similarly, the effectiveness of cost recovery involves the reliability and accuracy of the cost recovery model and related processes in measuring costs and reflecting those costs in the related charges. Effective cost recovery also includes appropriate revenue management.*

To satisfy these requirements, effective cost recovery arrangements generally involve a fit-for-purpose activity-based costing model, with the costs of providing activities linking to the prices and estimated revenues for those activities. This provides alignment between revenues and expenses for each activity over time, with minimal cross subsidies between activities. Where misalignment occurs, entities should be proactive in addressing structural over- and under-recovery of the costs of their activities. Entities should use levies to charge for activities provided to a group of individuals or organisations, and fees for activities provided to specific individuals or organisations. Efficiency is best captured in cost recovery arrangements by entities incorporating efficient costs in their cost recovery models, which can be determined through benchmarking with comparable entities and activities.

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<sup>1</sup> Department of Finance, *Australian Government Cost Recovery Guidelines*, Resource Management Guide No. 304, July 2014 — Third Edition, pp. 10–11.

3. Transparency and accountability also represent a cost recovery principle. In respect of the link between accountability and efficiency, paragraph 27 of the *Cost Recovery Guidelines* states that:

Access to cost recovery information can help stakeholders determine whether cost recovered activities are being implemented efficiently, effectively and consistently with Australian Government decisions, cost recovery and other government policies, and relevant legislation.

Transparency is also important in enabling scrutiny in respect of efficiency. Paragraph 28 of the *Cost Recovery Guidelines* states that:

In the cost recovery context, accountability involves ensuring that entities, their staff and the responsible Ministers are answerable for their actions and decisions in relation to cost recovery.

A key to transparency and accountability of cost recovery activities is for entities to update their cost recovery implementation statements (CRIS) at least annually. The CRIS should report historical cost recovery performance at the cost-recovered activity level, including metrics on balancing revenue and expenses for those activities over nominated timeframes and managing reserves. To support efficiency, the CRIS should also report financial estimates for the activity (i.e. expenses and revenue) for the budget year and forward estimates.

Once entities have met the requirements for transparency and accountability, as outlined above, they should take steps to also ensure that their processes are as efficient as possible. This can include monitoring the costs of the processes over time, and comparing costs with other similar entities. The Department of Finance may also be able to assist in this regard, through the biennial charging survey or other processes.

4. The audit reports on compliance with paragraph 41 of the *Cost Recovery Guidelines*, which requires that each cost recovery implementation statement must include:

the stakeholder engagement strategy, including a summary of the most recent consultation and stakeholder views.

The *Cost Recovery Guidelines* do not explicitly outline the benefit of developing a stakeholder engagement strategy, but do note at paragraph 30 that:

Successful stakeholder engagement is most likely to occur when it is well planned and when government entities enter into a meaningful dialogue with stakeholders, consider their views and, where appropriate, take action.

In this respect, a stakeholder engagement strategy can support successful stakeholder engagement. This can help stakeholders determine whether cost recovered activities are being implemented efficiently and effectively, and facilitate improvements where activities are not efficient and effective.

By documenting the engagement strategy and making it public, this keeps the entity focussed on an agreed set of activities and sets out what stakeholders can expect in terms of engagement. Through this, the process can realise efficiencies and accountability for delivering an effective cost recovery framework, by not only considering stakeholders' issues and perspectives but also through transparency providing an incentive for the entity to operate more efficiently.

5. (a) The audit report outlines the basis for concluding that each entity has established effective cost recovery governance and accountability arrangements at paragraphs 2.30 to 2.40.<sup>2</sup> As summarised in the grey box before paragraph 2.29:

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<sup>2</sup> Auditor-General Report No. 38 2018–19, *Application of Cost Recovery Principles*, pp. 30-32.

The arrangements include an internal management committee to oversee cost recovery activities and provide guidance to staff on implementation of cost recovery policies, and reporting to the committee and entity executive board on cost recovery performance.

The arrangements are considered effective in that they involved fit-for-purpose structures and processes at the operational level and appropriate oversight committees and reporting mechanisms to the Accountable Authority. Each entity had also conducted reviews at various times of their cost-recovery arrangements. While each entity had shortcomings in applying the cost recovery principles, the issues were generally identified through their governance and accountability arrangements, and were at various stages of being addressed.

(b) Yes. The governance and accountability arrangements for cost recovery are applicable to other administrative processes, such as broader financial budgeting and reporting arrangements. By publishing audit findings and key messages from the audit, the ANAO enables effective approaches used in one entity to be shared with other entities that are subject to the same policies and legislative requirements.

6. (a) As outlined at the hearing and recorded in the Committee Hansard of 15 November 2019 by Ms Enders of AMSA, *'a few months prior to the notification of the audit, AMSA had engaged an external consultant to conduct an internal review of our cost-recovery arrangements'*.

(b) The internal review report was prepared after the audit commenced in February 2018. It can be the case that the listing of a potential audit in the ANAO Annual Audit Work Program prompts an entity to undertake a review or reform process, but this does not necessarily remove the need for an audit to provide independent assurance to the Parliament.

7. As stated by the Auditor-General at the hearing and recorded in the Committee Hansard of 15 November 2019:

*... we flag our audits usually quite a bit in advance of when they start. Sometimes when we're developing up our program, it's not clear what work is underway. I can't say specifically for this one, because it was quite a time ago. I would say it's not unusual for us to find, when we commence an audit, that there was a process recently started within the agency to review the thing that we're about to go in and review. Do we take that into account? Yes, but it's not necessarily a determining factor. We go back to the objective of the audit and see whether it has a significant impact on it. If we were to cancel every audit because a department had started a process just before we started, we wouldn't be doing very many audits, I suspect.*

There is a substantial difference between management-initiated internal reviews where management sets the terms of reference, controls access to information, potentially influences the methodology applied, and does not make the results available publicly, and an independent audit by the ANAO that is made public and assists Parliament to scrutinise the entity's performance.

8. In conducting its audit work, the ANAO measures the cost of its work through charge out rates notionally applied to each audit (and actually applied for certain financial audit activities, for example in charging Government Business Enterprises for financial statements audits undertaken). Consistent with government policy, the ANAO aims to establish charge-out-rates at a level sufficient to notionally cost recover our activities over time. An hourly charge-out-rate is determined for each staff classification. The establishment of charge-out-rates is guided by a costing model that takes into account all relevant costs including the attribution of overhead costs and is designed to achieve full notional cost recovery of the ANAO operating budget. To incorporate efficiency into the costing arrangements, costs are benchmarked against other Australian jurisdiction audit offices.

The ANAO charge out rates are reported to the JCPAA annually as part of the Budget Submission. The 2019-20 ANAO Budget Submission to the JCPAA stated that:

...Section 14(1) of the Auditor-General Act 1997 provides for the Auditor-General to determine a scale of audit fees. The fees paid by Commonwealth entities for financial statement audits are returned to the Budget and are not available to the ANAO unless they relate to additional services.

In relation to audit fees, the Public Accounts and Audit Committee Act 1951, sub-section 8(k) requires the Committee to consider the level of fees determined by the Auditor-General under subsection 14(1) of the Auditor-General Act 1997.... Charge-out-rates are used to determine the notional or actual audit fee in respect of financial statement audits and to report the cost of performance audits....The ANAO will continue to consider the appropriateness of our current cost-recovery arrangements to ensure they best support the capacity of the office to support the delivery of its functions.

Performance audit cost can be impacted by a number of factors including the breadth of the audit (eg. number of criteria, number of entities), location of fieldwork, the need for specific expertise and the quality of evidence available and collected (eg poor records or delay of provision of records will increase costs).

Effectiveness is assessed at several levels. Technically, an effective audit meets the legislation and standards under which it is conducted, and a conclusion is formed within that framework. Effectiveness is also assessed taking account the value provided to the Parliament, and the impact it has within the public sector (for example, whether recommendations are agreed). Efficiency is measured at a program level in the ANAO's performance indicators, included in the PBS and reported in the annual report. The cost of each audit is included in each audit report for transparency.

To leverage individual audit impact, the ANAO also develops *ANAO Insights* products on key areas of public administration drawn from audits on related topics.

In this case, the audit represented value for money and effective use of funds and resources, as it provided coverage to an important issue affecting the efficiency of the operations of Australian Government entities, which has a direct cost impact on non-government entities. The audit also provided impetus for the audited entities to strengthen their cost recovery arrangements, including addressing some longstanding issues such as over-recovery from certain levies. In doing so, it provided messages for other cost recovery entities, and to the Department of Finance to clarify aspects of the Cost Recovery Guidelines and strengthen compliance arrangements across the Australian Government public sector. These have potentially high benefits across the sector. The cost of the audit, at \$560,000, was higher than the average for ANAO performance audits tabled in 2017–18 (of \$422,000). This reflected the relatively large audit scope and the number of entities included in the audit.

9. Yes.

9a. The audit objective and criteria remained unchanged from that established at the commencement of the audit. As often occurs in performance audits, some adjustments were made to the sub-criteria as the audit proceeded and the test program also evolved during the audit. The key changes involved:

- undertaking more or additional testing than originally envisaged in a number of areas, most particularly: the relative complexity of applications; the impact on processing of the 20 April 2017 announcement of proposed changes to the *Australian Citizenship Act 2007* that would apply retrospectively to applications from the date of announcement; and the impact of the introduction of increased integrity screening on processing times; and
- adjustments to reflect limitations in the department's data (for example, in relation to identifying and quantifying periods of processing inactivity) as well as one area where additional data was available for analysis than had been expected when the audit commenced (the department's systems were able to identify whether citizenship applicants were Illegal Maritime Arrivals).

10. The ANAO focussed on the period from July 2016 to June 2018 when examining the efficiency of the processing of applications for citizenship by conferral, but also undertook analysis of earlier periods.

In our examination of time-efficiency, the ANAO took into consideration trends from July 2014 and noted:

- The rates at which applications are lodged and applications are finalised last balanced in 2014–15 (see paragraph 2.1 and Figure 2.1).
- The rate of decisions taken had been declining over the period 2014–15 to 2017–18, falling far behind the lodgement rate, and a backlog of applications on hand resulted (see paragraph 2.2).
- The department's performance target in place for the three years of 2014–15 to 2016–17 was to decide 80 per cent of applications within 80 days of lodgement. The department last met this 80 day timeframe in 2014–15. In 2017–18 the department decided 15 per cent of applications within 80 days of lodgement, 96 per cent of which were to decide the application was invalid for processing (see paragraphs 2.12 to 2.15 and Figure 2.2).
- Each month since March 2017, the department has published how long it took to process citizenship applications the previous month. Performance has trended toward time-efficiency loss. That is, processing times have increased relative to March 2017. For example, the reported number of months from the date of application to the citizenship ceremony for '75 per cent of applications' has doubled from 10 months in the first report of March 2017 to be 20 months in the most recent report for October 2019 (see Figure 2.4 for reported processing times to September 2018 and the Home Affairs' website for the most recent report).

In our examination of resource-efficiency, the ANAO calculated the ratio of processing staff (inputs) to decisions taken (outputs) in 2016–17 and in 2017–18. The result indicated efficiency loss over the two-year period (see paragraphs 3.2 to 3.4 and Table 3.1). The ANAO did not extend this analysis to earlier years in consideration of the resources required for Home Affairs to compile reliable, historical data on staff allocated to the processing of citizenship by conferral applications as this was compiled manually. Outputs data was readily available and the ANAO noted that the number of decisions taken in the first quarter of 2018–19 increased significantly compared with the number taken in the first quarter of 2017–18, indicating an improvement in processing performance, but was below that being achieved in 2014–15, 2015–16 and 2016–17 (see paragraphs 3.19 to 3.20 and Figure 3.1).

11. No.

11a. The ANAO considered the response to this recommendation from the department in finalising the report and concluded that the recommendation remained appropriate. The type of information that would have supported not re-introducing externally reported key performance indicators (KPIs) could have included:

- how transparent and meaningful information would otherwise be provided by the department to the Parliament on whether Home Affairs' has been efficient in its processing of applications. As noted in the report, 'the published processing times help to show at what level the department is performing but do not state at what level the department *should* be performing' (paragraph 2.19). The report noted that externally reported targets is the approach still in place in other countries; and
- the department evidencing that the degree of applicant distress and complaints would be higher with externally reported KPIs than without, or that the risk of significant client

correspondence and complaints cannot be managed by ensuring the target set is realistic and through proactive communication with clients when their application exceeds the target.

12. At the time of the audit, the ATSB reported internally on both its time and resource efficiency but was only reporting externally on its time efficiency. The ATSB agreed to the recommendation that it report externally on its resource efficiency, although its comments in the audit report and its submission to the JCPAA did not address when and how it will begin to do this.

The ATSB's 2018–19 annual report was its first opportunity since the audit report was tabled to report externally on its resource efficiency. The ANAO has not been able to identify any reporting on resource efficiency by the ATSB in its 2018–19 annual report. Rather, the ATSB included in its annual report (on page 41) a commitment to review of its current set of deliverables and key performance indicators. The ATSB has advised the ANAO that:

- from a review of other like agencies it has identified that the best means to address both resources and time performance of its investigations function is through clear and measurable demand/capacity targets; and
  - it will be in a stronger position to quantify its key performance indicators and deliverables after it implements its Operational Improvement Program over the next 6-12 months.
13. The audit identified over-recovery and under-recovery in the three entities, with paragraph 9 in the conclusion of the audit report stating<sup>3</sup>:

Each entity also has scope to improve the effectiveness of its cost recovery arrangements. AMSA and Health have significantly over-recovered costs in recent years. Agriculture has over-recovered costs through levies and under-recovered costs through fees.

In respect of Agriculture, paragraph 14 noted, 'overall Agriculture has had a proportionately small under-recovery on its cost-recovered activities'.

The over-recoveries and under-recoveries were investigated as part of the standard audit processes. This involved analysis of the entities' financial information and reporting to confirm the scale of the misalignments, and dialogue with the entities to understand the reasons why they had occurred. These issues are primarily discussed in the section on Alignment between expenses and revenue on pages 40 to 48 of the audit report.

- (a) There is no definitive range of over-recovery and under-recovery (per cent) that is considered to be acceptable. The *Cost Recovery Guidelines* state at paragraph 37<sup>4</sup> that:

Ideally, the expenses and revenue should be aligned on a yearly basis. However, where justified, they can be aligned over a longer period (e.g. the business cycle of the activity). Government entities should develop mechanisms (e.g. internal control systems) to manage any under- or over-recovery. There must not be systematic over- or under-recovery of costs.

Recommendation 2(b) of the audit report proposed that the Department of Finance 'reviews and refines the Cost Recovery Guidelines to address issues listed at Appendix 2 of this audit'. The issues included requirements for entities to prevent systematic over- or under-recovery of costs as part of the annual Budget process (discussed at paragraphs 3.22 to 3.24).

- (b) The key processes to ensure adequate levels are recovered are the annual Budget process and the cost recovery implementation statement (CRIS).

In respect of the Budget process, paragraph 3.22 of the audit report states that:

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<sup>3</sup> Auditor-General Report No. 38 2018–19, *Application of Cost Recovery Principles*, p. 8.

<sup>4</sup> Department of Finance, *Australian Government Cost Recovery Guidelines*, Resource Management Guide No. 304, July 2014 — Third Edition, p. 14.



Requiring the alignment of expenses and revenue to be assessed as part of the annual Budget process would help to prevent any systematic over- or under-recovery of costs, particularly at the program or sector level.

Paragraph 38 of the *Cost Recovery Guidelines* states that 'entities should explain any variance between actual expenses and revenue in any one year'. This should be done through the CRIS, which paragraph 39 describes as:

... an explanatory document that provides key information on how cost recovery for a specific government activity is implemented. It reports how the activity is performing on an ongoing basis.

To provide clarity about the level of over-recovery or under-recovery by entities, the audit report included Recommendation 1(b) that the three entities 'report annually in their Cost Recovery Implementation Statements on their cost recovery performance at the regulatory activity level'. This would provide transparency, and allow scrutiny and debate by industry and other stakeholders about any misalignment of revenues and costs for regulated activities.

14.

- (a) Yes, a recommendation of the audit was that public annual progress reports for the Fourth Action Plan document the status of each action item and the outcomes of the National Plan as a whole.
- (b) Publishing achievements and outcomes would benefit the department by:
- creating open processes that allow stakeholders access to information. Clearly communicating the benefits of activities creates opportunities for participation and ownership and allows stakeholders to be part of the process of monitoring and reviewing outcomes;
  - contributing to the evidence base about what is and is not working, to allow stakeholders across jurisdictions to adjust activities;
  - providing a mechanism to demonstrate what actions are and aren't working for accountable for and how it is measuring success; and
  - providing a mechanism to articulate key dependencies (for example legislative changes, collaboration across jurisdictions) that will impact on outcomes. Identifying key dependencies facilitates oversight by other related parties.