

Expenditure

Introduction

- 3.1 The Committee reviews the financial statements of the six AIC agencies pursuant to section 29 of the *Intelligence Services Act 2001* (IS Act). All agencies, except ASIO, provided the Committee with a copy of their financial statements for the 2011-12 and 2012-13 financial years. ASIO's financial statements are publicly available in ASIO's *Report to Parliament 2011-2012* and *Report to Parliament 2012-13*.
- 3.2 The Committee reviewed the financial statements and took evidence from each agency and the Australian National Audit Office during private hearings. Much of the evidence received by the Committee is classified and has not been authorised for publication. The Committee scrutinised all material provided and questioned agencies on aspects of their expenditure. Following is an unclassified overview of the Committee's findings.
- 3.3 In scrutinising each agency's expenditure and overall financial position, the Committee sought evidence as to the agency's ability to meet its objectives within its budget parameters. In doing so, the Committee also sought assurances that each agency continued to have the necessary resources to address and target Australia's national security priorities to the degree necessary to protect Australians against the threats to national security.
- 3.4 The Committee heard that budget constraints, including the ongoing impact of the efficiency dividend and other savings measures, were placing increasing pressure on intelligence agencies.

Financial performance

- 3.5 Agencies updated the Committee on the financial management framework operating within their organisation and their general financial performance over the two reporting periods.

ASIO

- 3.6 ASIO's budget is set out in the Portfolio Budget Statements, with the audited outcome in ASIO's annual *Report to Parliament*.¹
- 3.7 In 2011-12, ASIO recorded an operating deficit of \$45.5 million due to net cash funding arrangements, and advised that its operating result was a loss of \$5.3 million against a Government approved operating loss of \$6.2 million.² ASIO noted this was a technical loss, attributable to the accounting treatment required for employee provisions due to interest rate movements.³
- 3.8 ASIO's revenue from Government in 2011-12 decreased by \$16.8 million from the previous year to \$328.1 million. This was due to savings provided to Government in prior year budgets.
- 3.9 ASIO submitted:
- ASIO's budget will continue to place pressure on our ability to meet the expectations of Government and the Australian public, and will continue to be impacted by ongoing Government efficiency dividends and absorbed additional functions.⁴
- 3.10 The impact of the efficiency dividend on agencies is discussed further below.
- 3.11 In 2012-13, ASIO recorded an operating deficit of \$45.1 million, due to net cash funding arrangements. Revenue from Government increased in this financial year to \$329.7 million. ASIO was approved to operate at a loss of \$13 million for costs associated with the move to the Ben Chifley Building. However, due to the delay in the move, ASIO sought to defer this loss to 2014-15. Excluding depreciation, ASIO reported a \$1.5 million surplus.⁵

1 ASIO (Review No. 11), *Submission 7*, p. 17.

2 ASIO (Review No. 11), *Submission 7*, pp. 15, 17.

3 ASIO (Review No. 11), *Submission 7*, p. 15.

4 ASIO (Review No. 11), *Submission 7*, p. 15.

5 ASIO (Review No. 12), *Submission 7*, p. 13.

3.12 ASIO submitted that it continued to absorb a range of additional costs, including those relating to:

- border security investigations,
- an increased number of visa security assessments,
- greater costs of telecommunications interception, and
- increased litigation activity.⁶

3.13 ASIO also advised that it had made a number of changes within the organisation to adapt to the changing fiscal environment, including reducing:

- ASIO's overseas presence,
- ASIO's foreign engagement for training purposes,
- the amount of domestic and overseas travel undertaken by ASIO officers, and
- the number of SES officers by 15 (25 per cent of all SES staff) through voluntary redundancies.⁷

3.14 While ASIO stated that it had been able to ensure an appropriate level of operational activity and longer term capability through its restructure and efficiency measures, it also warned:

While ASIO has been able to adapt to the constrained fiscal environment to date without significant diminution of its core operations, it will be increasingly difficult to do so in the future without having adverse operational effects.⁸

ONA

3.15 In 2011-12, ONA's appropriation was \$29.056 million plus a Departmental Capital Budget of \$6.022 million. ONA reported a number of appropriation changes in this financial year due to efficiencies and expired appropriations measures.⁹

3.16 ONA's operating budget for 2012-13 was \$28.176 million, 65 per cent of which was allocated to staffing costs, 10 per cent to property costs and 25 per cent to day-to-day running costs. ONA also received a Departmental

6 ASIO (Review No. 12), *Submission 7*, p. 13.

7 ASIO (Review No. 12), *Submission 7*, p. 13.

8 ASIO (Review No. 12), *Submission 7*, p. 13.

9 ONA (Review No. 11), *Submission 6*, p. 44.

Capital Budget of \$2.825 million to upgrade IT infrastructure and information management systems, and an additional \$0.67 million to provide and coordinate intelligence support to Australia's participation in the United Nations Security Council.¹⁰

- 3.17 ONA had an operating loss in 2012-13 of \$5.5 million, reduced to \$1.519 million after adjustments for unfunded depreciation expenses.¹¹

The efficiency dividend

Background

- 3.18 The efficiency dividend was first introduced in the 1987-88 Budget as part of a package of reforms designed to introduce managerial flexibility in the use of staffing and administrative resources within the public service.¹² Initially 1.25 per cent, the efficiency dividend was reduced to 1 per cent in 1994-95 and remained at that level until 2005-06. In the period 2005-06 to 2008-09, the efficiency dividend was 1.25 per cent. However, in 2008, the Government applied an additional one-off two per cent efficiency dividend, with the full year impact of this increase applied in 2008-09.¹³
- 3.19 In 2005-06, the Department of Defence, which was previously exempt, became subject to the efficiency dividend, with a phase in rate of 0.25 per cent per year for some civilian and non-operational functions and activities. In 2006-07 this was broadened such that the dividend covered approximately 14 per cent of Defence departmental expenditure. This was later reduced to 11 per cent in the context of the 2009 White Paper.¹⁴
- 3.20 As noted in the *State of the Service Report 2007-08*, while efficiency dividends are not new to the Australian Public Service, the size of an agency and/or the nature of an agency's activities could limit an agency's potential for generating cost saving productivity gains, year after year, of the magnitude required.¹⁵

10 ONA (Review No. 12), *Submission 2*, pp. 15-16.

11 ONA (Review No. 12), *Submission 2*, p. 16.

12 Parliamentary Joint Committee on Public Accounts and Audit, *Report 413: the efficiency dividend and small agencies: Size does matter*, December 2008, p. 1.

13 Parliamentary Joint Committee on Public Accounts and Audit, *Report 413: the efficiency dividend and small agencies: Size does matter*, December 2008, p. 2.

14 Department of Finance and Deregulation, *Report of the review of the measures of agency efficiency*, p. 69.

15 Australian Public Service Commission, *State of the Service Report 2007-08*, p. 137.

- 3.21 Since its inquiry for the *Review of administration and expenditure No. 7: Australian Intelligence Agencies*¹⁶, the Committee has monitored the impact of the efficiency dividend and other budget measures on the relevant agencies of the AIC, through its annual review of each agency's administration and expenditure. The Committee's ongoing concerns about the impact of the efficiency dividend on intelligence agencies has been reported to Parliament as part of these reviews, and are discussed in summary below.
- 3.22 In its review of agency expenditure for 2007-08, the Committee noted the report of the Joint Committee of Public Accounts and Audit, *The efficiency dividend and small agencies: Size does matter*.¹⁷ The Committee reported that the smaller intelligence agencies considered that the impact of the efficiency dividend on its performance would be significant if it was increased.¹⁸
- 3.23 However, the Committee was assured by agencies at the time that despite the impact of the efficiency dividend and irrespective of the funding they received, they had been able to appropriately resource their additional functions following on from the Flood and Taylor reviews, and had not experienced any degradation of capability. ASIO reported that year that it was still on track to reach its 2010-11 growth target of 1 860 staff.¹⁹
- 3.24 In its report on the *Review of administration and expenditure No. 8: Australian Intelligence Agencies*, the Committee noted again that no agency reported a significant degradation of capability for the reporting period. Nevertheless, the Committee heard evidence of reductions in capacity, and warnings that further reductions had the potential to significantly impact on operations:

ONA's submission stated that, as a result of the efficiency dividend, there would be 'some modest reduction in ONA's analytical capacity...' Another agency stated that any additional reduction in their budget would significantly impact their operational activities.²⁰

16 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 7 – Australian Intelligence Agencies*, May 2010.

17 Parliamentary Joint Committee on Public Accounts and Audit, *Report 413: the efficiency dividend and small agencies: Size does matter*, December 2008.

18 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 7 – Australian Intelligence Agencies*, May 2010, p. 38.

19 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 7 – Australian Intelligence Agencies*, May 2010, p. 38.

20 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 8 – Australian Intelligence Agencies*, June 2010, p. 46.

3.25 In its report for Review No. 8, the Committee recommended the Government review the potential adverse effects of the efficiency dividend on the AIC, having particular regard to the Joint Committee of Public Accounts and Audit report, *The efficiency dividend and small agencies: Size does matter*.²¹ However, the Government did not support the Committee's recommendation, stating in its response:

The efficiency dividend is an integral part of the devolved financial management framework where agencies are provided with the flexibility and autonomy to spend the funds appropriated directly to them by the Parliament... it is important to recognise the significant funding growth in the AIC over the last decade, which materially outweighs the size of the efficiency dividend for these agencies.²²

3.26 The Government response continued:

It [the Government] did accept that, from time to time, circumstances may arise in individual entities that magnify the impact of the efficiency dividend, and it concluded that such situations should be addressed individually on their merits by seeking additional funding through the budget process.²³

3.27 In its report *Review of administration and expenditure: Australian Intelligence Organisations, Number 9*, tabled on 18 June 2012, the Committee observed the same concerns from agencies regarding their ability to continue to meet operational needs, should their budgets be reduced further. Describing this advice as 'extremely concerning', the Committee reiterated its recommendation to the Government that it review the potential adverse effects of the efficiency dividend on the AIC.²⁴

3.28 In 2010-11, the Committee was informed of the continuing effect of the efficiency dividend on intelligence agencies. For example, in contrast to ASIO's advice in 2007-08, the Director-General of ASIO told the

21 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 8 – Australian Intelligence Agencies*, June 2010, p. 46.

22 Australian Government, *Government's Response to Committee's Recommendations - Parliamentary Joint Committee on Intelligence and Security, Review of Administration and Expenditure No. 8 – Australian Intelligence Agencies*, 22 September 2011, p. 7.

23 Australian Government, *Government's Response to Committee's Recommendations - Parliamentary Joint Committee on Intelligence and Security, Review of Administration and Expenditure No. 8 – Australian Intelligence Agencies*, 22 September 2011, p. 7.

24 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 9 – Australian Intelligence Agencies*, June 2012, p. 29. As this was not a formal recommendation of the Committee, it did not warrant a formal response from the Government.

Committee that ASIO could no longer reach the Taylor Review target for staff without additional funding:

I do not believe we can reach that target until we get access to new funding, which may be a year or so or longer depending on the economy down the track.²⁵

3.29 ASIO informed the Committee that, like other Commonwealth agencies, ASIO was under very tight budget pressures which it was addressing through an internal reform program designed to deliver efficiencies as well as developing capabilities. ASIO stated:

they are hard times for all parts of the government at the present time, and the intelligence community is not immune from that, but I am hoping that the measures we have taken will enable us to operate within budget without any significant loss of operating efficiency.²⁶

3.30 Commenting on the impact of the efficiency dividend, ONA argued that the impact on small agencies could be disproportionate. While ONA considered it had been able to meet the increased annual efficiency dividend to date, it told the Committee that the additional one-off 2.5 per cent efficiency dividend (to be applied in 2011-12) would put greater strain on its capacity to do its job and erode the gains that flowed from the Flood Report.²⁷

3.31 The then Director-General of ONA, Mr Allan Gyngell, told the Committee that the new efficiency dividend would 'certainly impede our ability to provide the coverage which we have provided in the past'.²⁸

Current review

3.32 In its review for the 2011-12 and 2012-13 financial years, the Committee sought assurances that the ongoing impact of the efficiency dividend and other savings measures were not adversely affecting the ability of the AIC to protect the safety and security of Australians and Australian interests.

25 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 10 – Australian Intelligence Agencies*, May 2013, p. 28.

26 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 10 – Australian Intelligence Agencies*, May 2013, p. 29.

27 Parliamentary Joint Committee on Intelligence and Security, *Review of Administration and Expenditure No. 10 – Australian Intelligence Agencies*, May 2013, p. 28.

28 *Classified transcript*, 23 March 2012, p. 26. See also, Byrne, Anthony MP, House of Representatives, Official Hansard, 27 May 2013, p. 3632.

- 3.33 The Committee notes that the DIAs have essentially been protected from the efficiency dividend. However, savings measures have impacted on these agencies over several financial years.²⁹

Developments in 2011-12

- 3.34 In 2011-12, the Government applied an additional 2.5 per cent efficiency dividend, in addition to the existing dividend of 1.5 per cent per year.³⁰
- 3.35 In evidence to the Committee, agencies confirmed that budgets remained under pressure due to the efficiency dividend and other government-imposed saving and efficiency measures. Agencies outlined measures taken to continue to absorb reductions in funding.
- 3.36 Agencies reported that increasing budgetary constraints required them to finely balance resources, to ensure that they could still meet the expectations of Government and the community, and respond to the changing security environment and ongoing threats to national security.
- 3.37 ASIO informed the Committee of its budgetary position in 2011-12, commenting that:
- ASIO's budgetary situation will continue to place pressure on our ability to meet the expectations of Government and the Australian public, and will continue to be impacted by ongoing Government efficiency dividends and absorbed additional functions.³¹
- 3.38 ASIO submitted:
- ASIO has been required to make some difficult decisions regarding prioritisation and resourcing of activity over the 2011-12 financial year, and this is expected to continue into subsequent years. The fundamental considerations underpinning such decisions are the need to continue to invest in capability as defined by the professional skills of our staff and the technologies required to support our business.³²
- 3.39 ASIO argued that intelligence capabilities were national resources that needed to be preserved with many of the skills essential to ASIO's success requiring years to develop.³³
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29 *Classified transcript*, 15 May 2014, p. 28.

30 Australian Public Service Commission, *State of the Service Report: State of the Service Series 2011-12*, p. 229.

31 ASIO (Review No. 11), *Submission 7*, p. 15.

32 ASIO (Review No. 11), *Submission 7*, p. 16.

33 ASIO (Review No. 11), *Submission 7*, p. 16.

- 3.40 Noting appropriation changes in 2011-12, including the additional 2.5 per cent efficiency dividend (on top of the 1.5 per cent dividend), ONA foreshadowed reductions in staffing levels and analytical capability.³⁴

Developments in 2012-13

- 3.41 In its submission for 2012-13, ASIO stated that although:

ASIO has been able to adapt to the constrained fiscal environment to date without substantial diminution of its core operations, it will be increasingly difficult to do so in the future without having adverse operational effects.³⁵

- 3.42 In evidence to the Committee, Mr David Irvine AO, Director-General of Security, argued that that ASIO should be considered a national capability with its technical skills and resources nurtured, developed and modernised in the same way as the military.³⁶ Mr Irvine reiterated his argument from 2011-12 that intelligence agencies such as ASIO required considered, continuous investment in capability.³⁷

- 3.43 In Mr Irvine's view, sustained investment is required to avoid a diminution in the ability of agencies to meet core functions:

It is totally logical that, unless we are putting the resources and capability into protecting Australians, then any reduction in those resources and capabilities will result in some ... diminution in our ability to give the government the sorts of assurances it wants from a security intelligence organisation.³⁸

- 3.44 One indicator of the impact of the efficiency dividend is the deferral of ASIO's objective to increase its staffing levels to 1 860 as recommended by the Taylor Review. Based on ASIO's financial status in 2012-13, Mr Irvine advised that the staffing target could no longer be met, unless additional funds were received:

I think the answer is that, over the past four or five years, we have not received the budgetary increases that would have been necessary in order to reach the 2006 established target of 1 860 people. Over the past four or five years, we have had new tasking

34 ONA (Review No. 11), *Submission 6*, pp. 43-44.

35 ASIO (Review No. 12), *Submission 7*, p. 13.

36 *Classified transcript*, 27 March 2014, p. 16.

37 *Classified transcript*, 27 March 2014, p. 16.

38 *Classified transcript*, 27 March 2014, p. 16.

added to our responsibilities and we have had money taken from us for efficiency dividends...³⁹

3.45 ONA reported a 7 per cent reduction in its annual appropriation in 2012-13 and that it had reduced administrative and capital costs to make efficiency dividend savings. Staffing levels over this period also declined to 144 at the end of 2012-13.⁴⁰ ONA noted a number of appropriation changes made in 2012-13 due to efficiencies and savings measures, including a temporary 2.25 per cent increase to the efficiency dividend.⁴¹

3.46 Specifically, ONA reported:

In 2012/13 the impact of the efficiency dividend and targeted savings was \$2.2 million with the cumulative impact of all budget reductions in 2012/13 and forward estimate (FE) years totalling \$14.201 million.⁴²

3.47 Future savings would be achieved through reducing administrative expenditure, travel and staff numbers. However, the Director-General of ONA, Mr Richard Maude told the Committee:

you cannot take that kind of money out of an organisation and just keep doing things exactly as you were. So, as you say, we are already and will continue to be pretty clear about our prioritisation. We will be doing less – and in some cases none, unless we have to – against lower priority issues in order to protect our output on higher priority issues.⁴³

3.48 Other agencies have also been increasingly required to prioritise activities in response to budgetary constraints.⁴⁴ For small agencies, this can have a significant impact:

over time [the efficiency dividend] does have disproportionate effects on small organisations, particularly small organisations whose major expenses are salaries. We just have fewer places to find the money. We do not run big programs. Ultimately, to find the money, we have to reduce our staffing levels.⁴⁵

39 *Classified transcript*, 27 March 2014, p. 4.

40 ONA (Review No. 12), *Submission 2*, pp. 16-17.

41 ONA (Review No. 12), *Submission 2*, pp. 16-17.

42 ONA (Review No. 12), *Submission 2*, p. 16.

43 *Classified transcript*, 16 May 2014, p. 10.

44 *Classified transcript*, 27 March 2014, pp. 6-7. *Classified transcript*, 15 May 2014, p. 29.

45 *Classified transcript*, 16 May 2014, p. 14.

3.49 Agencies also commented on the cumulative effect of the efficiency dividend on operational capability. The Committee was informed that:

If you look at the cumulative effect of the efficiency dividend ... it is significant. What it is doing and what it will do over time is to erode our operational ability and capability, because resources are disappearing and ... we do not have the projects that we can stop doing. What we can stop doing is conducting operations.⁴⁶

3.50 Other evidence stated that:

In my view we have reached the point now where, if there are any further significant cuts – and there will be if efficiency dividends continue and with inflation, so the real value of our budget is going down – then we as an organisation will need to look at making much more serious capability reductions.⁴⁷

Other savings measures

3.51 All intelligence agencies outlined a number of savings measures implemented over the reporting period to reduce expenditure and achieve efficiencies. These savings measures were implemented either as a result of or in addition to the efficiency dividend.

Defence Strategic Reform Program

3.52 The Defence Intelligence Agencies reported on the Defence Strategic Reform Program (SRP), a key efficiency initiative intended to reform Defence and deliver \$20 billion in savings in the period 2009 to 2019. Savings of \$36 million were reported in the Intelligence and Security Group⁴⁸ across a range of non-operational areas, travel and contract rationalisation, effectively delivering the Group's contribution to the SRP.⁴⁹

46 *Classified transcript*, 16 May 2014, p. 27.

47 *Classified transcript*, 27 March 2014, p. 15.

48 The Defence Intelligence and Security Group comprises AGO, ASD, DIO and Defence Security Authority.

49 DIGO (Review No. 11), *Submission 3*, p. 4.

- 3.53 In 2012-13, DIAs reported that Defence had adopted a broader reform agenda and that the SRP had been integrated into other reform activities, most notably the Shared Services reform.⁵⁰

Shared services

- 3.54 Throughout the APS, there has been a move towards implementing shared services as a means of delivering efficiencies.⁵¹ Over the reporting periods, ONA and the DIAs informed the Committee of the implementation of shared services programs within those agencies.
- 3.55 ONA reported in 2011-12 and 2012-13 that it had a range of shared services with the Department of the Prime Minister and Cabinet (PM&C):
- ONA benefits from a shared services arrangement with PM&C, including use of the departmental library services, mail services, financial management and information systems, and human resources information systems.⁵²
- 3.56 ONA also noted that Whole of Australian Government initiatives had led to cost savings in areas such as travel, software licensing, procurement and contract management, and other goods and services.⁵³
- 3.57 As noted above, shared services reforms were implemented in the DIAs over 2011-12 and 2012-13. These reforms were to deliver streamlined and centralised enterprise-wide processes across the finance, human resources, ICT, non-materiel procurement and security domains.⁵⁴
- 3.58 In 2011-12, the DIAs used the Intelligence and Security Group's Graduate Development Program to test the efficacy of Defence-wide human resource consolidation. This program aimed to consolidate the entry for all Defence graduates through a single gateway.⁵⁵
- 3.59 In 2012-13, the DIAs reported that the move to shared services had impacted on established policies and procedures as staff across the
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50 See AGO (Review No. 12), *Submission 4*, p. 5; DIO (Review No. 12), *Submission 4*, p. 7; ASD (Review No. 12), *Submission 5*, p. 8.

51 *State of the Service 2011-12*, p. 233.

52 ONA (Review No. 12), *Submission 2*, p. 18.

53 ONA (Review No. 11), *Submission 6*, p. 19; ONA (Review No. 12), *Submission 2*, p. 19.

54 See DIGO (Review No. 11), *Submission 3*, p. 6, AGO (Review No. 12), *Submission 3*, p. 5; DIO (Review No. 11), *Submission 4*, pp. 6-7, DIO (Review No. 12), *Submission 4*, p. 7, DSD (Review No. 11), *Submission 5*, pp. 5-6, ASD (Review No. 12), *Submission 5*, pp. 8-9.

55 See DIGO (Review No. 11), *Submission 3*, p. 5, AGO (Review No. 12), *Submission 3*, p. 5; DIO (Review No. 11), *Submission 4*, pp. 6-7, DIO (Review No. 12), *Submission 4*, p. 7, DSD (Review No. 11), *Submission 5*, pp. 5-6, ASD (Review No. 12), *Submission 5*, pp. 8-9.

finance, human resources, ICT, non-materiel procurement and security areas were transferred out of the Intelligence and Security Group.⁵⁶ While it was reported that this had not resulted in any degradation of capability,⁵⁷ the loss of these staff presents implications for agencies in achieving future savings. The Committee was informed:

The difficulty we face at the moment is that there is essentially very little in the back of house to trim, largely because of the shared services agenda in Defence. So the human resources, finance, contract management and other functions like that are no longer part of the Intelligence and Security Group; they belong to other groups who provide those services out to the rest of Defence. So, essentially now, when we have to make hard choices it is about intelligence capability.⁵⁸

Travel

- 3.60 Agencies reported on measures taken to achieve cost reductions in the travel expenditure. One agency reported that the average cost of each overseas and domestic trip had decreased in 2012-13, due to lower airfares arising from strict use of the best fare of the day and greater use of economy-class travel. Other agencies reduced the amount of domestic and overseas travel undertaken by staff over the reporting period.

Committee comment

- 3.61 As part of its review of expenditure for each of the intelligence agencies, this Committee and Committees of previous parliaments have sought information on the ongoing impact of budgetary pressures on agencies.
- 3.62 The Committee's role is not to question the operational priorities of intelligence agencies. Nor is its role to assess what level of resourcing is required for agencies to fulfil the objective of protecting Australians and Australian interests from threats to national security.
- 3.63 Rather, the Committee has a responsibility to report to the Parliament (and the wider Australian community) the result of its reviews into the

56 AGO (Review No. 12), *Submission 3*, p. 5, DIO (Review No. 12), *Submission 4*, p. 7, ASD (Review No. 12), *Submission 5*, p. 9.

57 AGO (Review No. 12), *Submission 3*, p. 5, DIO (Review No. 12), *Submission 4*, p. 7, ASD (Review No. 12), *Submission 5*, p. 9.

58 *Classified transcript*, 15 May 2014, p. 22.

administration and expenditure of intelligence agencies. This includes shining a light on any evidence that suggests agencies do not or will not have adequate resources to fulfil their responsibilities, either now or into the future.

- 3.64 In reviewing the budget and expenditure of the intelligence agencies over the 2011-12 and 2012-13 financial years, the Committee was informed that agencies are continuing to balance resources in a tight fiscal environment, and absorb efficiency dividends, without 'significant diminution of core operations'. To achieve this, agencies have had to make difficult decisions and tightly balance priorities. The Committee was informed, however, that continued or further budgetary cuts would impact on agency operations.
- 3.65 The Committee is not in a position to determine at what point there might be a 'significant diminution of core operations'. Due to the nature of intelligence gathering and assessment, and an ever-changing security environment, it is also difficult for agencies to assess at what point resources will prove inadequate. Further, risks are not static and may escalate at any time, placing pressure on agencies capacity to respond.
- 3.66 While agencies are prudently implementing savings measures to absorb the impact of the efficiency dividend and other reductions in revenue, it is clear to the Committee that agencies are either reaching or have reached the point where they may no longer be able to address national security priorities if current funding patterns continue.
- 3.67 The Committee has sufficient evidence before it to demonstrate that the continued implementation of the efficiency dividend and other savings measures will affect operations. The Committee views the risks associated with reducing an agency's operational capacity or capability as akin to the risks associated with reducing Australia's Defence capability.
- 3.68 Further, as ASIO submitted, the unique skills and capability of our intelligence officers and agencies is acquired over time. If agencies do not have the resources required to develop and maintain the skills necessary to meet the changing security environment, the consequences could be catastrophic.
- 3.69 The Committee notes that its 2010 recommendation that the Government review application of the efficiency dividend and other savings measures to the Australian Intelligence Community was not accepted. Particular consideration should be given to the adverse effects of these measures on operational capacity and the ongoing impact on agencies' ability to protect Australia's national security. For years further on, the Committee states its

view that the ongoing application of the efficiency dividend or other savings measures to the AIC places Australia's national security at risk. It is the view of the Committee that the efficiency dividend and other savings measures should not continue to be applied at the same rate, or that exemptions should be available to the AIC.

Recommendation 2

The Committee recommends that the Australian Government review the continued application of the efficiency dividend and other savings measures to the agencies comprising the Australian Intelligence Community. Particular consideration should be given to the cumulative impact of these measures on operational capacity, including maintaining optimal staffing levels, and the ongoing ability of agencies to protect Australia's national security.

Financial management

Internal controls

- 3.70 Each intelligence agency has an internal financial management framework and internal systems controls as required by the *Financial Management and Accountability Act 1997* (FMA Act) and the *Financial Management Accountability Regulations 1997* (the FMA Regulations).⁵⁹
- 3.71 The Commonwealth Fraud Control Guidelines, issued under the FMA Regulations, outlines agency requirements to introduce and enforce a comprehensive fraud control program that covers prevention, detection, investigation and reporting strategies.⁶⁰
- 3.72 Due to changes to the FMA Act during 2011-12, agencies advised of the need to transition their internal audit committees to include risk management.⁶¹ For example, ASIO's Audit and Evaluation committee

59 For further information, see <http://www.finance.gov.au/financial-framework/fma-legislation/fma-act.html>; <http://www.finance.gov.au/financial-framework/fma-legislation/fma-regulations.html> viewed 2 May 2014.

60 Commonwealth Fraud Control Guidelines, <http://www.ag.gov.au/CroimeAndCorruption/FraudControl/Pages/CommonwealthFraudControlGuidelines.aspx> viewed 2 May 2014. See also s 45, FMA Act.

61 See Regulation 22C, FMA Regulations, s 46, FMA Act.

transitioned to an Audit and Risk committee, with ASIO appointing an independent chair and ensuring that the committee's work plan complied with the FMA Act.⁶² ONA renamed its Audit Committee the Audit, Risk and Assurance Committee (ARAC), with the committee chaired by the Deputy Director-General and an external member appointed.⁶³

- 3.73 The ARAC agreed to audits of various corporate and financial functions by an independent internal auditor during 2011-12. This auditor also assisted in managing the ARAC and compliance reporting. ONA submitted that this function added another layer of governance to ensure best practice.⁶⁴ Audits completed during 2011-12 were provided to ARAC and all recommendations were accepted by management in accordance with agreed timeframes.⁶⁵
- 3.74 In addition, the internal auditor reviewed ONA's compliance with the Government's financial management framework. In this process, the auditor identified several process improvements, which ONA stated were being implemented.⁶⁶
- 3.75 In 2012-13, ARAC agreed to audits being undertaken in debtor management, compliance with the Protective Security Policy Framework and ONA Procurement. Again, ONA advised that all recommendations made in the audits were accepted by management and were being implemented.⁶⁷
- 3.76 A Defence-wide Audit Branch ensures that financial and operational controls are in place to manage Defence's major risks effectively and efficiently. During both reporting periods, Audit Branch provided internal audit services in accordance with the annual Audit Work Program approved by the Defence Audit and Risk Committee.⁶⁸
- 3.77 During 2012-13, ASIO consolidated changes made to its risk governance structure to entrench a positive risk culture. ASIO's internal audit area also completed a range of tasks to improve organisational performance, including undertaking compliance audits and completing fieldwork into

62 ASIO (Review No. 11), *Submission 7*, p. 27.

63 ONA (Review No. 11), *Submission 6*, p. 16.

64 ONA (Review No. 11), *Submission 6*, p. 16.

65 ONA (Review No. 11), *Submission 6*, pp. 16-17.

66 ONA (Review No. 11), *Submission 6*, p. 17.

67 ONA (Review No. 12), *Submission 2*, p. 15.

68 Defence Annual Report 2011-12, p. 133; Defence Annual Report 2012-13, p. 114.

operational expenditure across ASIO to assist the Australian National Audit Office in conducting its financial statements audit.⁶⁹

Fraud control

- 3.78 ASIO advised that throughout 2011-12, fraud control processes were redesigned to consolidate responsibility and accountability for fraud control to ASIO's Internal Audit Unit. During this time, ASIO maintained a Fraud Control Plan and Fraud Policy.⁷⁰
- 3.79 There were three allegations of fraud identified within the agency over 2011-12, with two instances confirmed. These were resolved through adjustment of leave entitlements and increased management oversight.⁷¹
- 3.80 In 2012-13, ASIO refreshed its fraud risk assessment, which identified a series of fraud risks that were found to be appropriately mitigated by controls in ASIO security and financial frameworks. ASIO developed and implemented the *ASIO Fraud Control Plan 2013-15*. ASIO received four allegations of fraud over the period, with no fraud activities confirmed.⁷²
- 3.81 Defence's fraud and risk management planning is outlined in its annual reports, which also cover the DIAs. In 2011-12 and 2012-13, Defence Fraud Control Plans Numbers 10 and 11 were approved respectively.⁷³ In 2012-13, Defence integrated its fraud control framework with the Defence enterprise risk management system to ensure closer alignment to Defence's strategic priorities.⁷⁴
- 3.82 ONA advised that there were no instances of alleged fraud against ONA during 2011-12 or 2012-13.⁷⁵

External controls

- 3.83 The Australian National Audit Office (ANAO) conducts an annual examination of the internal systems and key financial controls of ONA, ASIO and ASIS, by auditing each agency's financial statements. These agencies are required to produce annual financial statements in

69 ASIO (Review No. 12), *Submission 7*, p. 29.

70 ASIO (Review No. 11), *Submission 7*, p. 24.

71 ASIO (Review No. 11), *Submission 7*, p. 24.

72 ASIO (Review No. 12), *Submission 7*, p. 29.

73 Defence Annual Report 2011-12, p. 133, Defence Annual Report 2012-13, p. 37;

74 Defence Annual Report 2012-13, p. 37.

75 ONA (Review No. 11), *Submission 6*, p. 17; ONA (Review No. 12), *Submission 2*, p. 15.

accordance with section 49 of the FMA Act.⁷⁶ ANAO then audits each organisation under section 57 of the FMA Act.⁷⁷

- 3.84 ASIO and ASIS are audited by special agreement between their relevant ministers and the Minister for Finance. The respective Chief Executives have discretionary power to omit certain financial information that could reasonably be expected to be operationally sensitive from their statements.⁷⁸
- 3.85 The Committee notes that new agreements will be required when the *Public Governance and Accountability Act 2013* replaces the FMA Act.
- 3.86 The DIAs are not required to produce separate financial statements under the FMA Act. Rather, the revenues, expenses, assets and liabilities of those agencies are included in the annual financial statements of the Department of Defence and are audited as part of ANAO's broader auditing across Defence.⁷⁹
- 3.87 At the Committee's invitation, the Auditor-General provided a submission to Reviews No. 11 and 12, reporting on the results the ANAO's financial statements audits. Representatives of the Australian National Audit Office also appeared before the Committee.
- 3.88 In its audits of ONA and Defence, ANAO reports on whether in its opinion the financial statements:
- have been prepared in accordance with the Finance Minister's Orders
 - give a true and fair view of each agency's financial position at the end of the reporting period and its performance and cash flows for the reporting period.⁸⁰
- 3.89 For ASIS and ASIO, ANAO reports on whether in its opinion the financial statements:
- have been prepared in accordance with the Agreement between the Finance Minister and the relevant Minister
 - give a true and fair view of matters required by the Agreement.⁸¹

76 ANAO (Review No. 12), *Submission 1*, p. 1.

77 *Classified transcript*, 15 May 2014, p. 11.

78 ANAO (Review No. 11), *Submission 8*, p. 1; ANAO (Review No. 12), *Submission 1*, p. 1.

79 ANAO (Review No. 11), *Submission 8*, p. 1; ANAO (Review No. 12), *Submission 1*, p. 1; *Classified transcript*, 15 May 2014, p. 11.

80 ANAO (Review No. 12), *Submission 1*, p. 1.

81 ANAO (Review No. 12), *Submission 1*, p. 2.

ASIO

- 3.90 In both financial years, ANAO assessed the risks of material misstatement associated with ASIO's financial statements as normal, due to:
- the reporting requirements, which were not complex
 - ASIO's experienced and stable financial team, which has been proactive in addressing any weaknesses in its accounting system identified by the ANAO.⁸²
- 3.91 ANAO reviewed the governance arrangements, financial reporting regime and internal control system that ASIO has adopted. ANAO noted that ASIO's arrangements include a number of management committees to evaluate ASIO's direction and financial results, an internal audit function and an audit committee.⁸³
- 3.92 ANAO found no audit issues for ASIO in 2011-12 or 2012-13.⁸⁴

ASIS

- 3.93 ANAO also assessed the risk of material misstatement associated with ASIS' financial statements as normal. After reviewing the financial statements and identifying ASIS's governance arrangements, financial reporting regime and internal control system, ANAO found no new audit issues in 2011-12 or 2012-13.⁸⁵

ONA

- 3.94 ANAO assessed the risk of material misstatement associated with ONA's financial statements as low, with no audit issues identified in 2011-12 or 2012-13.⁸⁶

Defence Intelligence Agencies

- 3.95 ANAO advised that no specific issues of significance were raised with the DIAs during its audits of the Department of Defence in 2011-12 and 2012-13.⁸⁷

82 ANAO (Review No. 12), *Submission 1*, p. 2.

83 ANAO (Review No. 12), *Submission 1*, p. 2.

84 ANAO (Review No. 11), *Submission 8*, p. 2; ANAO (Review No. 12), *Submission 1*, p. 2.

85 ANAO (Review No. 11), *Submission 8*, p. 3; ANAO (Review No. 12), *Submission 1*, p. 3.

86 ANAO (Review No. 11), *Submission 8*, p. 3; ANAO (Review No. 12), *Submission 1*, p. 3.

87 ANAO (Review No. 11), *Submission 8*, p. 3; ANAO (Review No. 12), *Submission 1*, p. 3.

Committee comment

- 3.96 The Committee has scrutinised each agency's financial management, including its internal controls. On the basis of the evidence received, the Committee was satisfied that agencies are appropriately managing the expenditure of their organisations.

Mr Dan Tehan MP
Chair

September 2014