

## **Performance Audit Report No. 25 (2012-13)**

# Defence's Implementation of Audit Recommendations

### **Audit objective and scope**

- 2.1 The objective of the audit was to assess the effectiveness of the systems employed by the Department of Defence's (Defence) to monitor the implementation of both internal and external audit recommendations.
- 2.2 The audit examined whether Defence's procedures and systems:
  - provided adequate visibility and assurance on the status of audit recommendations to the department's internal audit function and the Defence Audit and Risk Committee (DARC); and
  - facilitated the adequate implementation of recommendations in a timely manner.
- 2.3 This chapter should be read in conjunction with ANAO Report 25 of 2012-13.

### **Background**

- 2.4 Defence has an established internal audit function, led by the Chief Audit Executive and is periodically subject to ANAO performance audit.
- 2.5 The Defence Audit and Risk Committee (DARC) is responsible for, amongst other things, monitoring the implementation of audit recommendations and advising the Secretary of Defence and the Chief of the Defence Force on significant issues identified in audits.<sup>1</sup>

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<sup>1</sup> ANAO Report No. 25 2012-13, p. 11.

- 2.6 As an FMA Act agency, the Defence Materiel Organisation (DMO) also has an audit committee and an internal audit function. However, Defence's audit function has final authority for closing DMO-related recommendations arising from ANAO and departmental audit reports. DMO is responsible for monitoring and closing recommendations from DMO internal audits.<sup>2</sup>

## Audit Conclusions

- 2.7 The audit report concluded that Defence's systems exhibited many positive elements such as:
- clear processes for assigning responsibility;
  - systematic monitoring and reporting on progress by Defence internal audits; and
  - clear allocation of roles and responsibilities within Defence regarding the implementation of audit recommendations.
- 2.8 The ANAO also found a number of weaknesses in the system, including:
- inconsistent follow-up on slow implementation of recommendations;
  - a lack of escalation to senior management in situations in which there are ongoing difficulties; and
  - difficulties achieving closure on the implementation of recommendations within specified timeframes.
- 2.9 The ANAO concluded that whilst monitoring and reporting are necessary, these conditions alone are not sufficient to achieve timely and adequate implementation of audit recommendations.<sup>3</sup> The audit report commented that:
- ...by not implementing agreed audit recommendations in a timely manner, Defence is forgoing opportunities to enhance its performance.<sup>4</sup>

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2 ANAO Report No. 25 2012-13, p. 12.

3 ANAO Report No.25 2012-13, p. 84.

4 ANAO Report No.25 2012-13, p. 15.

## Audit recommendations

2.10 The audit report made two recommendations.

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1. The ANAO recommends that, to achieve the full benefit of audit recommendations: Defence reinforce managers' responsibilities for implementing agreed recommendations; and the Defence Audit and Risk Committee bring to the attention of the Secretary and Chief of the Defence Force, on an exception basis, any recommendations of particular concern that have not been implemented.

**Defence's response:** *Agreed*

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2. The ANAO recommends that the Defence Audit and Risk Committee, in accordance with its charter, provide an annual written report to the Secretary and Chief of the Defence Force on the operation and activities of the Committee. The report should include advice on the overall effectiveness of: Defence Groups' implementation of audit recommendations; and Defence's monitoring and reporting arrangements.

**Defence's response:** *Agreed*

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## The Committee's review

- 2.11 Representatives of Defence and the ANAO gave evidence at the Committee's public hearing on 13 February 2014.
- 2.12 The review groups issues of concern under the following headings:
  - governance and accountability;
  - monitoring and reporting; and
  - timeliness.
- 2.13 The sections below canvas selected ANAO findings identified by the Committee as key areas of interest.

## Governance and accountability

- 2.14 ANAO found that Defence's system and procedures for monitoring and reporting implementation provide adequate visibility and assurance on the status of audit recommendations. However, timeliness of implementation was found to be a 'significant problem'.<sup>5</sup>

- 2.15 The Auditor-General also drew attention to the fact that the monitoring of audit recommendations was not one of the DARC's stated priorities, although it is a required under its Charter.<sup>6</sup> ANAO also found that while DARC has the ability to call upon Group Heads and responsible officers to explain why recommendations are overdue, this has not occurred in recent years as the committee has turned its focus to other areas of risk in Defence. Further, the DARC made a verbal but not a written report to the Secretary, despite this being required by its Charter and recommended in the ANAO Better Practice Guide to Audit Committee.<sup>7</sup>
- 2.16 In evidence to the Committee, Defence welcomed the audit report and advised the Committee that the Defence Committee and Minister are now provided with regular advice on the implementation of internal and ANAO performance audit recommendations.<sup>8</sup> The Defence Committee is chaired by the Secretary, and the involvement of the Defence Committee has elevated accountability for implementation of audit recommendations to the highest level within the Department.<sup>9</sup>
- 2.17 Monitoring the status of audit recommendations is now a standing item on the DARC agenda, and the DARC has: '...resumed annual reporting to the secretary on its operations and activities'.<sup>10</sup>
- 2.18 It was also clarified that the Chief Operating Officer and the Vice Chief of Defence Forces sit on both the DARC and the Defence Committee; and the Chair of DARC holds an annual meeting with the Defence Committee to discuss broad observations about the organisation.<sup>11</sup>

## Monitoring and reporting

- 2.19 The Audit Recommendations Management System (ARMS) is used to trace the status of recommendations but, while ANAO found the ARMS to be basically functional, it concluded that ARMS is outdated and not user-friendly. ANAO examined the system and found that ARMS was updated infrequently, and support documents attached inconsistently.<sup>12</sup>
- 2.20 Defence gave evidence that the ARMS database, which runs off a Lotus Notes database system, is obsolete, and advised the Committee that the department would be moving to SharePoint as soon as possible. This evidence was later corrected to clarify that if there is no support for the

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6 Statement by Auditor-General, *Submission 2*, p. 2

7 ANAO Report 25 2012-13, p. 14

8 Mr Brown OAM, Department of Defence, *Committee Hansard*, 13 February 2014, p. 9.

9 Mr Brown OAM, Department of Defence, *Committee Hansard*, 13 February 2014, p. 9.

10 Mr Brown OAM, Department of Defence, *Committee Hansard*, 13 February 2014, p. 9.

11 Mr Brown OAM, Department of Defence, *Committee Hansard*, 13 February 2014, p. 13.

12 ANAO Report 25 2012-13, p. 18.

ARMS in the future, Defence may change to an alternative system.<sup>13</sup> In other words, Defence does not see ARMS as obsolete at this point in time.

## Timeliness

- 2.21 The timeliness of implementation was also identified as a weakness. ANAO found that while the procedures for monitoring and reporting on implementation provided adequate visibility and assurance on the status of recommendations, the timeliness of implementation is a significant problem.<sup>14</sup> The ANAO found that the average time taken to complete a recommendation (combined internal and external) was 275 days, with an average delay in completion, compared to the original estimated completion date, of 88 days.<sup>15</sup>
- 2.22 The statistics on a selected sample of 48 internal audit recommendations found the average time assigned for completion was 272 days. The average delay for internal audit recommendations was significantly greater, at 190 days, with actual time taken, including extensions, a significant 429 days.<sup>16</sup>
- 2.23 ANAO also found that approximately half of the 28 ANAO recommendations examined in the audit were not adequately implemented although Defence reported them as fully implemented.<sup>17</sup>
- 2.24 In response to a question on notice, Defence advised that the figure of 88 days is based on a combination of data originating from audits in 2007-08 and 2009-10:
- Since that time there has been a measurable improvement in completing recommendations. For example, a comparative sample for recommendations arising from all audits in 2011-12 shows that the average delay in completion of recommendations is 53 days.<sup>18</sup>
- 2.25 The Auditor-General expressed concern that there are no consequences for responsible officers and Defence Groups for not implementing recommendations in a timely manner.<sup>19</sup>
- 2.26 ANAO found that the reasons for delay were a mixture of individual attitudes and hurdles of bureaucracy. During the hearing the issues of

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13 Mr Brown OAM, Chief Audit Executive, correspondence, 4 March 2014; *Submission 3.1*, p. 1.

14 ANAO Report No. 25 2012-13, p. 15.

15 See Table 3.2, ANAO Report No. 25 2012-13, p. 69.

16 See Table 3.4, ANAO Report No. 25 2012-13, p. 73.

17 Statement by Auditor-General, *Submission 2*, p. 2.

18 Department of Defence, *Submission 3*, Response to Question on Notice, p. 1.

19 Statement by Auditor-General, *Submission 2*, p.2.

staff turnover, the demands of military postings, general cultural matters and the complexity of Defence's dual workforce were all canvassed.<sup>20</sup>

- 2.27 Dr Ioannou from the ANAO, observed that range of issues had been identified as effecting the timely completion of recommendation. The audit had conducted interviews with internal staff, that shed some light on these matters, including that some staff new to positions were deciding that:

... they did not agree with recommendations, or they were not a priority and therefore, in a sense, did not progress them, notwithstanding the fact that the department had agreed to them formally.<sup>21</sup>

- 2.28 In response to the ANAO audit, Defence advised that a new process for the closure of recommendations had been implemented. Responsible officers are now required to produce a 'closure pack', with supporting evidence, signed by an SES officer or equivalent ADF. The Audit Branch now verifies the required changes have been 'realised' before authorising closure.<sup>22</sup> In follow up evidence to the Committee, the Chief Audit Executive clarified that the minimum requirement is sign off at the 'one star' level (SES Band 1 or ADF equivalent). The closure of recommendations is reported two-monthly to the Secretary and Minister of Defence.

## Committee Comment

- 2.29 Under s. 44 of the *Financial Management and Accountability Act 1997* (FMA Act), Chief Executives have a legal responsibility to manage the affairs of their agency in a way that promotes the best use of Commonwealth resources.
- 2.30 Chief Executives are also required to establish and maintain an audit committee with functions which include: helping the agency to comply with obligations under the FMA Act, the Regulations and Finance Minister's Orders; and providing a forum for communication between the Chief Executive, the senior managers of the agency and the

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20 See, *Committee Hansard*, pp.12-13.

21 Dr Ioannou, ANAO, *Hansard Transcript*, 13 February 2014, p.11.

22 Mr Geoffrey Brown OAM, Department of Defence, *Hansard Transcript*, 13 February 2014, p.9.

- Auditor-General.<sup>23</sup> The Directors of a Commonwealth authority are also required to establish and maintain an audit committee.<sup>24</sup>
- 2.31 The Committee notes the Auditor-General's expressed disappointment at the findings of the audit, and is concerned to ensure that the reforms implemented to address the weaknesses are maintained. The Committee is concerned by the long-time delays, and apparent incomplete reporting that has been identified by the audit.
- 2.32 The purpose of internal and external auditing is to identify weaknesses and better enable an organisation to address risk. The benefits of this work are undermined if agencies do not institutionalise robust monitoring, implementation, reporting and oversight mechanisms.
- 2.33 The evidence given during the hearing has provided some comfort to the Committee, that the systems and processes are being strengthened to ensure a higher level of formality, with clearer documentation and appropriate levels of senior executive engagement and responsibility for outcomes. The Committee also acknowledges the ongoing work to address culture issues and to instil greater understanding of democratic accountability.
- 2.34 In particular, the elevation of reporting and oversight to the Defence Committee, and the formalised role of the DARC are both appropriate and necessary. These measures better accord with the legal duties of senior Commonwealth officials, responsible for the utilisation of public resources and reporting to the responsible Minister.
- 2.35 The Committee encourages Defence to implement the ANAO recommendations in full. In particular, to ensure that its internal systems comprehensively capture and correctly describe the status of both internal and external audit recommendations.
- 2.36 The Committee is concerned that the ARMS database is approaching the end of its useful life, and that Defence should give greater priority to investigating an alternative system. The experience of other agencies, is that a system that is 'fit for purpose' is essential to underpin comprehensive data capture, monitoring and reporting to appropriate levels of seniority within the Department. Regardless, no system is a substitute for institutionalising a culture of accountability. The Committee is pleased that a stronger role for the internal auditors is being established, and sees this as essential to promoting greater understanding across all levels of the department.

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23 *Financial Management and Accountability Act 1997 (FMA Act)*, s. 46.

24 *Commonwealth Authorities and Companies Act 1997; Commonwealth Authorities and Companies Regulations 1997*.

**Recommendation 1**

2.37 The Committee recommends that:

- the Department of Defence investigate options for an improved database system for the monitoring and reporting of internal and external audit recommendations; and
- adequate resources are allocated to an improved database system to ensure a higher level of assurance to senior levels of the department and the Minister.