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Audit Report No. 25, 2002–2003

Financial Statements of Commonwealth Entities for 2001–02

Introduction

Background

7.1 The *Financial Management and Accountability Act 1997* (FMA Act) and the *Commonwealth Authorities and Companies Act 1997* (CAC Act), require the Auditor-General to report each year on whether the financial statements of Commonwealth entities have been prepared in accordance with the Finance Minister's Orders, and whether they give a true and fair view of the matters required by those orders.[1]

7.2 The ANAO is responsible for the audit of the financial statements of 257 Commonwealth entities. These include:

- 82 agencies;

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1 Section 57 of the FMA Act sets out the requirements for agencies and clause 3, part 2 of Schedule 1 of the CAC Act sets out the requirements for other Commonwealth bodies.

- 117 Commonwealth authorities and their subsidiaries; and
- 42 Commonwealth companies and their subsidiaries.[2]

7.3 The material portion of the Commonwealth's revenues, expenses, assets and liabilities in the 2001–2002 financial year are accounted for by a relatively small number of Commonwealth entities, notably:

- the Department of Defence (Defence);
- the Department of Family and Community Services;
- the Department of Health and Ageing; and
- the Australian Taxation Office (ATO).[3]

The audit

7.4 The audit focused on the final results of the financial statement audits for 2001–2002. These included the Consolidated Financial Statements (CFS) and the financial statements of Commonwealth entities. The audit report also included comments on financial management issues arising from the audits, in particular their relation to internal control structures.

Audit findings

7.5 The significant findings and comments in the audit report were:

- comments on the harmonisation of standards used to prepare the Commonwealth's two key financial reports—the CFS and the Final Budget Outcome (FBO);
- comments on the timeliness of the preparation of entity financial statements;
- audit qualifications of the CFS concerning:
  - ⇒ the estimation of taxation revenue by the taxation liability method (TLM) which did not conform to AAS 31 *Financial Reporting by Governments*;
  - ⇒ the accounting treatment of the collection of the Goods and Services Tax (GST);

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2 Auditor-General, *Audit Report No. 25, 2002–2003, Financial Statement Audit, Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002,* Canberra, December 2002, p. 12.

3 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 12.

  - ⇒ insufficient audit evidence to support the figure for Defence's inventory and repairable items under the Specialist Military Equipment balance;

- an 'emphasis of matter'[4] in relation to the CFS because of inherent uncertainty about the potential Commonwealth liabilities arising from both the HIH Insurance Group collapse and the indemnity provided to the provisional liquidator of United Medical Protection Ltd and Australasian Medical Insurance Ltd (UMP / AMIL);[5, 6] and
- four financial statements which were qualified:
  - ⇒ the CFS, for differences in accounting policies and limitations in scope (referred to above);
  - ⇒ the ATO, for a disagreement in the accounting treatment of its lease of IT equipment;
  - ⇒ Defence, concerning its inventory and specialist military equipment repairable items (referred to above); and
  - ⇒ the National Gallery of Australia, because its reliance on fund raising through public donations could not assure the completeness of its revenue.[7]

The Committee's review

7.6 Four agencies were invited to give evidence to the Committee at a public hearing on Wednesday, 30 April 2003. The agencies were:

- the ANAO;
- the ATO;
- Defence; and
- the Department of Finance and Administration (Finance).

7.7 The Committee took evidence on the following issues:

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4 An emphasis of matter is not an audit qualification. It can arise because of inherent uncertainty in the figures reported in a statement; when information in the document containing the financial statement is inconsistent with that in the financial report; and when it is highly unlikely the entity will continue as a going concern because of information arising after reporting and there has been adequate disclosure in the financial statements.

5 The CFS had recognised a Commonwealth liability of $496 million for the HIH collapse and $500.8 million for the UMP / AMIL liquidator. Both were based on actuarial assessment, but the final amounts were uncertain. This was noted on the audit of the CFS as an 'emphasis of matter'.

6 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 31.

7 Auditor-General, *Audit Report No. 25, 2002–2003,* pp. 36–7.

- harmonisation of Australian and international accounting standards;
- auditing of the FBO;
- timeliness in the preparation of Commonwealth entity financial statements;
- qualification of Defence's financial statement;
- use of the TLM for estimating taxation revenue;
- accounting treatment of GST revenue; and
- accounting treatment for the lease of ATO's information technology equipment.

Harmonisation of accounting standards

7.8 The Commonwealth's two key financial reports—the CFS and the FBO—are prepared using two different external reporting standards. The two standards are Australian Accounting Standard 31, *Financial Reporting by Governments* (AAS31) and the Government Finance Statistics (GFS).

7.9 AAS31 comprises a set of rules concerned with measuring economic transactions and events, and presenting those measurements in a manner that conveys financial performance, financial position, cash flows and other relevant disclosures. The aim is to provide users with relevant information to enable resource allocation decisions and to report on stewardship.

7.10 The GFS framework was developed by the International Monetary Fund in co-operation with the World Bank, Eurostat and the Organisation for Economic Co-operation and Development (OECD). The aim of the GFS is to measure the impact of public policy, including the measurement of a government's contribution to the economy. It facilitates public sector input into the preparation of national accounts.[8]

7.11 The CFS is prepared under AAS31, is audited and is tabled in Parliament some time after the end of each financial year.[9] On the other hand, the FBO contains some information prepared under AAS31 and other information prepared under GFS. The FBO contains audited information (that prepared under AAS31) and unaudited information, and is required under the *Charter of Budget Honesty Act 1998* to be tabled by 30 September each year.

8 Finance, *Briefing Paper to the JCPAA*, 17 June 2003.

9 For the 2001–02 Financial Year the CFS was tabled on 29 November 2002.

7.12 The audit report commented:

> The two frameworks often result in confusion and difficulties in interpreting information. While a considerable amount has been done to harmonise the reporting frameworks, significant differences remain, including in respect of the treatment of:
>
> - revaluation of assets;
> - foreign exchange gains and losses;
> - interest flows related to swaps and other financial derivatives; and
> - acquisitions of defence weapons platforms.[10]

7.13 The ANAO supported the harmonisation of reporting standards. It noted that while it was primarily a matter for the Australian Accounting Standards Board, support from stakeholders involved in public sector accounting would be needed, especially in the light of Australia's commitment to adopt international accounting standards by 2005.[11] (A briefing paper prepared for the Committee by Finance noted that the harmonised standard is to take effect by 1 July 2004.)

7.14 Finance told the Committee that the OECD had a keen interest in creating a single reporting framework and had recently examined the treatment of defence weapons platforms. The Australian Accounting Standards Board had also started reviewing a draft strategic plan to deal with harmonisation, which called for the Board to review draft standards in early 2004.[12]

Auditing the Final Budget Outcome

7.15 Division 3, Schedule 1 of the *Charter of Budget Honesty Act 1998* requires the Treasurer to publicly release and table the FBO no later than 3 months after the end of the financial year.

7.16 The Final Budget Outcome comprises four parts:

- Part 1: Budget aggregates (revenue, expenses, net capital investment, cash flows, net debt and net worth) for the general government sector;[13]
- Part II: Commonwealth financial statements (operating statement, balance sheet, cash flow statement) for the general government sector, public non financial corporations and public financial corporations;[14]

10 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 18.

11 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 19.

12 Mr Brett Kaufmann, *Transcript*, 30 April 2003, pp. 62–3.

13 Principally entities bound by the FMA Act.

- Part III: Primary financial statements for the general government sector; and
- Part IV: payments to local governments, states and territories (GST revenue, general revenue assistance, general purpose assistance to local government, and specific purpose payments to the states and territories).

7.17 The FBO has not been audited.[15]

7.18 In *Report 388, Review of the Accrual Budget Documentation*, tabled in June 2002, the Committee recommended that the FBO should be audited by the ANAO.[16]

7.19 The ANAO response to the recommendation agreed that an audit would provide additional assurance to users of the FBO, but added that this initiative would have resource implications for the ANAO and that it was a matter for the Government and the Parliament to decide.[17]

7.20 The Government did not agree to the Committee's recommendation. The Government response to the recommendation stated:

> The Government notes that the Final Budget Outcome must be published by 30 September, in accordance with the *Charter of Budget Honesty Act 1998*. Under present arrangements this deadline is met with little time to spare. Therefore, the introduction of a complete audit process would compromise this legislative requirement. As the individual agency accounts that are consolidated into the FBO are audited, there is already an implicit audit process undertaken.
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> The Consolidated Financial Statements (CFS) for the Commonwealth are already audited by the Australian National Audit Office. Under the *Financial Management and Accountability Act 1997* the CFS must be tabled within five months of the end of the financial year. Given that audit of the CFS already provides assurance on aggregate financial statements, the Government does

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14 Bodies covered by the FMA Act and entities bound by the CAC Act, such as the Reserve Bank of Australia and other borrowing authorities.

15 However, before the adoption of the accrual accounting framework by the Commonwealth, the Finance Minister's Aggregate Financial Statement (AFS) contained a section called the 'Budget Outcome'. This section was expressed in a cash accounting terms and contained some, but not all, of the information that is now contained in the FBO. The AFS was audited.

16 JCPAA, *Report 388, Review of the Accrual Budget Documentation,* Canberra, June 2002, Recommendation 11, p. 81.

17 Auditor-General, *Response to Report 388*, 6 September 2002, p. 3.

> not consider it necessary to add another layer of checking for the FBO with associated consequences for what is already a tight FBO timetable.[18]

7.21 The ANAO provided further advice regarding the potential audit of the FBO in the audit report:

> The issue of relevant standards to be used would be central to such an audit.
>
> An audit of the FBO Report would, in the first instance, entail a review of the general government sector component of the CFS, to ensure consistency of input to, and presentation of, the FBO Report. Secondly, a component of such an audit would include a review of the Commonwealth financial statements to determine adherence with the relevant GFS framework.[19]

Timeliness of preparing financial statements

7.22 In auditing the 2001–02 financial statements of Commonwealth entities, the ANAO noted that there had been a deterioration in timeliness when compared to the statements of the previous year:

- the first draft financial statements for presentation to the ANAO took 45 days in 2001–02, an increase of 19 days;
- signed financial statements were produced after 65 days, an increase of 5 days; and
- financial statements were tabled in Parliament 116 days after the end of the financial year, an increase of 6 days.[20]

7.23 The ANAO suggested that the decline in timeliness was due to the restructuring of a number of agencies following the Administrative Arrangements Order of 26 November 2001 and changes to financial reporting requirements outlined in the 2002 Finance Minister's Orders.

7.24 Nevertheless, the recommendations of the Finance Budget Estimates and Framework Review required a progressive improvement in the timeliness of reporting accrual budget outcomes. As a result, for the 2004–05 financial

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18 Senator the Hon Nick Minchin, Minister for Finance and Administration, *Government Response to Report 388,* 2 May 2003, p. 4.

19 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 19.

20 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 21.

year, entities would have to 'improve the timeliness of their financial reporting by, on average, at least 25 days.'[21]

7.25 To meet this target entities would have to re-engineer and upgrade processes focussing on speed of processing and reporting, while also improving data integrity and financial analysis. There was also the need to produce quality monthly financial reports with supporting analysis and involve the senior executive group in the process.[22]

7.26 The Committee explored with witnesses the challenges facing agencies in the timely presentation of financial statements for audit. Defence responded that it had:

> … an old system that was not designed for this environment, which forces us to rely on substantive processes, quality assurance processes, and work-around processes to achieve quality in the results.[23]

7.27 Whereas Defence was confident it could present 'signed off reports' in a more timely manner in 2002–03, the ANAO did not display a similar level of confidence.[24]

7.28 The ANAO told the Committee that the Department of the Treasury (Treasury) took twice as long to prepare its draft financial statements because of the complexity of bringing to account the figures involved in the HIH Support Scheme and the Medical Assistance Scheme.[25] The Committee notes that the level of uncertainty surrounding the figures resulted in a an 'emphasis of matter' by the ANAO.

7.29 Finance provided the Committee with further information on timeliness in the following table:

Table 1 Average no. of days to lodge audit cleared financial statements with Finance compared with due date.

Agency	2000–01 actual	Target days	2001–02 actual	Target days	Slippage between years	Slippage from target
Material	47.6	46	48.6	46	1	2.6
Small	68	79	77.4	78	9	0

Source Finance, *Submission No. 14*, p. 4.

21 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 22.

22 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 23.

23 Mr Lloyd Bennett, *Transcript,* 30 April 2003, p. 58.

24 Mr Michael Watson, *Transcript*, 30 April 2003, p. 58.

25 Mr Trevor, *Transcript*, 30 April 2003, p. 59.

7.30 Finance advised that smaller agency audits are scheduled to commence after the audits of the material agencies in their portfolio are completed. As well, the introduction of monthly financial reporting for small agencies in 2003–04 'should lead to improvements to their financial reporting processes and procedures once it becomes a regular and ongoing activity.'[26]

7.31 In *Report 388,* the Committee recommended that the reporting requirements for agency annual reports should be brought forward by one month to 30 September. While the Government did not agree, it advised that earlier targets for the provision of financial information by agencies had been agreed to. With the implementation of these targets progressively 'over the next three years' the Government may then be in a position to reconsider the issue of deadlines for tabling of annual reports.[27]

Committee comment

7.32 The Committee still considers that the FBO should be audited. However, there are two significant impediments to achieving this goal:

- the need to determine which audit standards to use to audit the FBO; and
- the difficulty of preparing and also auditing the FBO within three months of the end of the financial year.

7.33 The Committee supports the efforts of Finance to facilitate the harmonisation of reporting standards, but cautions that harmonisation should not come at the expense of the quality provided by the existing Australian standard. When harmonisation is achieved—and the target is 1 July 2004—the first impediment would largely be overcome.

7.34 The Committee is encouraged by the move to progressively bring forward the provision of financial information by agencies. When this is achieved, audited financial statements will be available for incorporation into whole of government reports at an earlier date. Consequently, completion of the FBO could be expected earlier, which would provide more time if it was decided to audit the FBO. Thus the second impediment could largely be overcome through the passage of time.

26 Finance, *Submission No. 14,* p. 4.

27 Senator the Hon Nick Minchin, Minister for Finance and Administration, *Government Response to Report 388,* 2 May 2003, p. 2.

7.35 The Committee will continue to have an interest in the initiative of auditing the FBO, but recognises that this goal is achievable only in the medium term.

The qualification of Defence's financial statement

7.36 Defence's financial statements were qualified because there was insufficient audit evidence to support the figures for Defence's inventory and the repairable items under the Specialist Military Equipment balance. This qualification flowed through to the CFS because of the materiality of the issue.

7.37 The audit opinion resulted from the lack of controls over the Standard Defence Supply System (SDSS) which manages the items. Users of the system were able to enter data directly into the price field without sufficient controls and it was not possible to assess with confidence the cumulative financial effect of prices that had been inadvertently adjusted or incorrectly calculated. The ANAO had also criticised the price integrity of explosive ordnance on the COMSARM logistics system. [28]

7.38 At the hearing the ANAO referred to specific problems identified in the audit report which included:

- more than $482 million of the $1 574 million of asset write-downs were generated by the SDSS;
- $243 million of the $694 million worth of assets brought onto the books were generated by the SDSS;
- prices of explosive ordnance were changed at operational level without documentation and retention of the rationale;
- where explosive ordnance was purchased under contract with escalation clauses, the system did not record the accurate value;
- the ANAO did not have confidence as to the existence of all the assets recorded on the SDSS at 'positions' outside Defence warehouses, notwithstanding the 'signing off' by Defence that the processes were robust;
- some $187 million worth of Specialist Military Equipment had a fifty per cent chance of not being recorded; and
- total unrecorded assets could be as high as $255 million.[29]

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28 Auditor-General, *Audit Report No. 25, 2002–2003,* pp. 30–1.

29 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 87.

7.39 Defence assured the Committee that the issue of inventory pricing and repairable items did not impact on Defence's 'capability to perform, nor [did] they reflect any demands on cash or any fraudulent activity.'[30]

7.40 Defence continued by drawing attention to the limitations of its SDSS:

> [It was] very much designed on quantity managing an item as opposed to capturing the financial information … It was developed in the early eighties … it was put in place before the requirement for accrual accounting came in. So it was never designed as a financial management tool. … When you issue assets from warehouses to the bases … that is where the system is weak at the moment. That is because it is allowing people to issue to the base, and the base does not necessarily keep that information up to date on the system. … We are not confident of the quantities on the system. We are now trying to get people to do the stocktakes on the bases to verify and clean up the numbers.[31]

7.41 Regarding the issue of potential fraud, the ANAO advised the Committee that Defence conducted fraud control and statistically 'there is a low volume of reported fraud in the Department.'[32]

7.42 The Committee notes that Defence assets and operating expenses constitute a substantial part of the Commonwealth's assets and outlays. Ongoing problems with Defence's ability to account for its assets is of concern to the Committee. While **reported fraud** is said to be statistically low, continued poor accounting and controls provides the opportunity for fraud to occur and remain undetected.

The use of the taxation liability method for estimating taxation revenue

7.43 The CFS for 2001–02 was prepared, as in past years, using the TLM which recognises taxation revenue when tax payments are due and payable. The method does not conform to AAS 31 *Financial Reporting by Governments* because all taxation revenue, assets and liabilities are not recognised in the period when the underlying transactions occurred.

7.44 In contrast, the Australian Taxation Office (ATO) accounted for taxation revenue on an accruals basis using the economic transactions method (ETM). This method recognises taxation revenue when the economic

30 Mr Lloyd Bennett, *Transcript,* 30 April 2003, p. 41.

31 Ms Ann Thorpe, *Transcript,* 30 April 2003, pp. 41–2.

32 Mr Michael Watson, *Transcript,* 30 April 2003, p. 42.

activities raising the tax liability occur and take account of any estimated refunds and/or credit amendments to which taxpayers might be entitled. The ETM meets the requirements of AAS 31.[33]

7.45 The difference between TLM and ETM is that under ETM, taxation revenue is recognised earlier in the taxation cycle. In a growing economy the consequence is that ETM revenue would generally be higher than TLM revenue. [34]

7.46 The ANAO concluded that for the 2001–02 financial year the operating result was overstated by $2.8 bn and the net liabilities were overstated by $7.6 bn. The audit report noted that the use of the TLM was consistent with the treatment adopted for the 2001–02 Budget. As well, while Finance and Treasury did not take the view that ETM provided a reliable measure of taxation revenue, they recognised the comparable reliability of the two methods should be reviewed in future years.

7.47 Because the CFS was compiled using the TLM, which did not conform to AAS31, it received a qualification from the ANAO. ATO's financial statements were unqualified on this issue.[35]

7.48 The ATO told the Committee that the ETM required a greater level of estimation than the TLM. However the variance between the two methods was reducing as regards GST revenue because the quarterly activity statements reduced the delay between the point when the liability was accrued and when it was recognised. [36] The ANAO added that, in contrast, with company tax and individual tax there could be a significant delay between the end of the financial year and the lodgement of a tax return when the liability was recognised.[37]

7.49 Finance quantified the variance when it advised the Committee that in the 2001–02 consolidated statements the ETM value had to be adjusted by $653 million. While this only represented 0.4% of total revenue, for consolidated statements the level of materiality set by the ANAO was $350 million. [38]

7.50 Finance explained that this level of materiality was due to public interest in the consolidated statement's bottom line. Where the result could vary

33 Auditor-General, *Audit Report No. 25, 2002–2003,* pp. 27–8.

34 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 28.

35 Auditor-General, *Audit Report No. 25, 2002–2003,* p. 28.

36 Ms Donna Moody, *Transcript,* 30 April 2003, p. 50.

37 Mr Allan Thompson, *Transcript,* 30 April 2003, p. 50.

38 Mr James Kerwin, *Transcript,* 30 April 2003, pp. 51–2.

from plus to minus $5 billion, a figure of $653 million would have a significant effect.[39]

7.51 In contrast, the ATO used the ETM for its own financial statements as there was a higher materiality threshold because the figures were in comparison to total taxation revenue. [40]

7.52 A supplementary submission from Finance advised that the TLM method had been introduced for the 1998–99 financial year.[41] Finance told the Committee that the two methods were under ongoing review, but that even though the variances between the two methods had improved there was still too great a swing on a materiality basis to allow the approach to be changed. Finance confirmed that was for the Finance Minister to decide whether to revert back to the ETM.[42]

The accounting treatment of GST revenue

7.53 The 2001–02 CFS as in previous years, was qualified because it had been prepared without recognising the Goods and Services Tax (GST) as Commonwealth revenue. The audit report noted the Government's reason as being that the GST was a State tax collected by the Commonwealth in an agency capacity in accordance with the intent of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Arrangements.*

7.54 However, the ANAO disagreed, arguing that the GST was part of Commonwealth revenue because:

- The GST was imposed under Commonwealth legislation and therefore the Commonwealth controlled the revenue raised.
- The relativity factor which adjusted the subsequent payments to the States was determined by the Commonwealth Treasurer. Consequently, the distribution of the GST collected would only coincidentally reflect the amount of tax collected in each jurisdiction.

7.55 The audit report noted that the financial statement of the ATO reported the GST as a Commonwealth tax and the Treasury financial statement reported the subsequent payments to the States as grant expenses. As well, the Australian Bureau of Statistics treated the GST as a Commonwealth tax for statistical purposes.[43]

39 Mr Ian McPhee, *Transcript,* 30 April 2003, pp. 53–4.

40 Ms Donna Moody, *Transcript,* 30 April 2003, p. 53.

41 Finance, *Submission No. 14,* p. 5.

42 Mr Ian McPhee, *Transcript,* 30 April 2003, pp. 55–6.

43 Auditor-General, *Audit Report No. 25, 2002–2003,* pp. 29–30.

7.56 At the hearing, Finance acknowledged the treatments by the ATO and Treasury, and noted that there was agreement on the actual amount of tax collected. [44] However, Finance stated:

> … it is the Finance Minister who prepares the whole-of-government accounts, and I think the Government have made it very clear—from their perspective at least—that the GST is not a Commonwealth tax but a State tax. That reflects the treatment, therefore, that is represented in the Government's accounts.[45]

7.57 The Committee believes that in the face of this impasse there is little to be gained from further debate on the issue.

Australian Taxation Office accounting treatment of information technology outsourcing

7.58 The financial statements of the ATO were qualified because it accounted for the lease of its computer equipment as an operating lease. The ANAO considered the lease should be a finance lease under AAS 17 *Leases.* This was because substantially all the risks and benefits had passed from the lessor to the ATO.[46]

7.59 Many Commonwealth entities, including the ATO, had guaranteed the residual value of the equipment on expiry of the lease or where the equipment had become surplus. As such they bore the risk associated with a decline in residual value below that agreed to. Since residual value risk was the most significant risk associated with asset ownership, the ANAO believed such arrangements should be classified as finance leases.[47]

7.60 The audit report noted that in 2001–02 three Commonwealth entities had changed their accounting treatment for these leasing arrangements from operating leases to finance leases. However, six entities had retained the operating lease treatment. Of these only the ATO's lease had a material effect. Hence only the ATO's financial statements had been qualified.[48]

7.61 The ATO told the Committee that the 2001–02 qualification was the third year of qualification and the contract had two more years to run. The ATO added that it had recently exercised a partial option in the contract for a range of services for another two years. [49]

44 Finance, *Transcript*, 30 April 2003, pp. 46–7.
45 Finance, *Transcript*, 30 April 2003, p. 46.
46 Auditor-General, *Audit Report No. 25, 2002–2003*, p. 36.
47 Auditor-General, *Audit Report No. 25, 2002–2003*, p. 44.
48 Auditor-General, *Audit Report No. 25, 2002–2003*, p. 44.
49 Ms Donna Moody, *Transcript*, 30 April 2003, pp. 42–3.

7.62 In determining the accounting treatment, the ATO had received a range of legal advice. The ANAO responded that it had looked at the ATO's legal advice, but it was 'still of the opinion that their IT assets are a finance lease.'[50]

7.63 The ATO advised the Committee that its accounting treatment did not materially affect ATO's statement of financial performance. (A supplementary submission from the ATO indicated that the cumulative effect on operating expenses for the three years of the lease was an understatement of $375 000.[51]) However, the ANAO had considered the ATO's assets to be understated by about $46 million with liabilities similarly understated. These figures were not disclosed in the financial statements.[52]

7.64 In renewing the lease, the ATO told the Committee that it was considering whether any developments warranted a change in the accounting treatment.[53] The Committee suggested that the wording of the renewed lease could be clarified to confirm where the risks actually lay. The ATO responded that the issue was:

> … whether we can do that in a way that does not cost the Commonwealth any more money and does not impact on the services or any of the other things in the contract.[54]

7.65 The Committee notes that to date there appear to have been few major problems with the outsourcing arrangements for ATO's IT. However, it is only when such problems arise that the underlying risk of the contract will become apparent. Nevertheless, the Committee believes it would be prudent if the ATO took advantage of the renewal of the lease to resolve the disagreement with the ANAO.

Recommendation 5

7.66 **The Australian Taxation Office should review the terms of its information technology outsourcing contract when the contract is renewed so that the nature of the lease is clarified and the subsequent accounting treatment does not attract an audit qualification.**

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50 Ms Donna Moody, Mr Allan Thompson, *Transcript,* 30 April 2003, p. 44.

51 ATO, *Submission No. 12,* p. 1.

52 Ms Donna Moody, *Transcript*, 30 April 2003, pp. 42–3.

53 Ms Donna Moody, *Transcript*, 30 April 2003, p. 43.

54 Ms Donna Moody, *Transcript*, 30 April 2003, p. 44.