

AUSTRALIAN NATIONAL AUDIT OFFICE SUBMISSION



Cost Recovery-ANAO Practice

ANAO operations include the practice of cost recovery for our audit services. An outline of this practice is set out below.

Part 4 of the Auditor-General Act 1997 outlines the mandate of the Auditor-General in which encompasses the financial statement audit (Division 1) and performance audit (Division 2) of all Commonwealth agencies, companies and subsidiaries and audits by arrangement with any person or body (Division 3). Section 14(1) provides that, in respect of certain entities whose financial statements are audited, audit fees are payable "based on a scale of fees determined by the Auditor-General". Section 14(4) requires that "the basis on which the Auditor-General determined the audit fees" must be disclosed in the Annual Report for the relevant year. Section 20 (2) extends the levying of fees to audits by arrangement. The Auditor-General has complete discretion in the manner the fees (prices) are determined.

In practice audit fees are calculated on an accrual-based costing model to determine an hourly charge out rate for each level of audit staff. The costing model takes into account all relevant costs including the attribution of overhead costs. The latter costs do not include those costs associated with meeting the Auditor-General's broader governance responsibilities such as costs relating to international and Commonwealth-State relations and the additional costs incurred as a result of being located in the Parliamentary triangle.

The ANAO regularly reviews its cost recovery arrangements including a consideration of issues relating to contestability of services and appropriate product benchmarks.

Cost Recovery - Recent Audit Reports

There have been three recent audit reports that have addressed the issue of cost recovery directly. These three reports are *Costing of Services* tabled in December 1998, *Management of Commonwealth Non-primary Industry Levies* tabled in February 2000 and *AQIS Cost-Recovery Systems* tabled in September 2000. Copies of these reports are enclosed.

Costing of Services: This report was an examination of costing approaches and methodologies in a number of organisations. It addressed the way public sector organisations process and use information about the cost of their activities. It examined the processes from the dual perspective of the approach used to identify and allocate costs and the appropriateness and robustness of the supporting costing systems.

The audit found that:

- most organisations had simple cost systems where the collection and use of cost information was limited to particular purposes in satisfaction of mainly external requirements rather than to service internal management needs;
- the systems to capture the necessary data were largely unstructured;
- a small number of organisations had progressed to a stage where full cost information was used to support their decision making processes; and
- no organisation had reached the stage where costing information on an accrual basis played a key strategic role in overall decision making.

While the audit identified that some organisations had a good understanding of the basic requirements of costing, most organisations needed to develop more sophisticated cost approaches if they are to effectively fully cost outputs and monitor performance as required in the new accrual budgeting framework .

A significant effort in a short period of time is required by most organisations if the benefits from the focus on outputs, performance and outcomes under this new framework are to be achieved.

In the majority of organisations, not all the requirements of an effective control framework were in place. Weaknesses identified included shortcomings in the content of policy and procedural documentation; cost allocation techniques; and the decision making processes associated with setting prices/user charges. In addition, at times, cash data were not correctly adjusted to reflect full cost nor was a sufficient level of relevant training available to the staff concerned.

Management of Commonwealth Non primary Industry Levies: This report examined a range of levies with particular attention to the assessment of coverage revenue and expenses, and the effectiveness of the financial management. The audit concluded that, in general, most Commonwealth entities had established sound governance, including control structures to manage levy collections effectively. Nevertheless, the findings indicated that the financial management of a minority of levies will require a stronger executive management focus if they are to achieve the results required.

Levies may have the objective of full cost recovery, partial cost recovery, or they may be set at a predetermined level without reference to costs. It was also concluded that the extent to which levy revenue is intended to recover costs, and the time period over which this should occur, needed to be established at the outset. Most levies examined in the audit were designed with the intention of recovering the costs associated with the levy activity. It was found that, for 1998–99, four of the short term levies, which accounted for over half of the revenue, achieved cost recovery levels that were within 10 per cent of reported costs; for other levies, entities had either not identified the cost of administration and/or the level of recovery did not bear a direct relationship to costs.

In the course of the audit ANAO developed a checklist of administrative requirements to evaluate entities' financial management of levies. The checklist summarises financial management issues comprising: legislative compliance; identification of levy payers; identification of costs; assessment of liability and invoicing; receipting

and banking; debt recovery; records management; risk management; review and evaluation; and cost recovery. The development of these practices drew on examples of sound administration found in a number of entities covered in this audit.

AQIS Cost-recovery Systems: This report focused on the effectiveness and efficiency of the management of the AQIS cost recovery systems, with particular emphasis on the recovery of the full costs of the services provided without cross subsidisation. The ANAO concluded that, overall, that the AQIS cost recovery systems were mature and stable and, with some exceptions, have delivered near cost recovery for the AQIS recoverable programs. Notwithstanding this, AQIS cost recovery systems contained a number of inherent weaknesses that potentially impair the efficiency and effectiveness of the management of those systems. In particular as AQIS generally seeks to recover its costs at a recoverable program level, it was not able to sufficiently assure itself or stakeholders that the programs were identifying and recovering the full costs of each type of service provided without cross subsidisation for some services. More effective cost-recovery systems were needed to achieve a substantial degree of assurance in this regard.

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