



PUBLIC ACCOUNTS COMMITTEE

First Home Owner Grant Scheme



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Charter of the Committee

The Public Accounts Committee has responsibilities under the *Public Finance and Audit Act 1983* to inquire into and report on activities of government that are reported in the State's Public Accounts and the accounts of the State's authorities.¹ The Committee, which was established in 1902, scrutinises the actions of the Executive Branch of Government on behalf of the Legislative Assembly.

The Committee recommends improvements to the efficiency and effectiveness of government activities. The sources of inquiries are the Auditor-General's reports to Parliament, referrals from Ministers and references initiated by the Committee. Evidence is primarily gathered through public hearings and submissions. As the Committee is an extension of the Legislative Assembly, its proceedings and reports are subject to Parliamentary privilege.

Members of the Committee

The Committee comprises members of the Legislative Assembly and assumes a bi-partisan approach in carrying out its duties.

Chairman: Joseph Tripodi MP, Member for Fairfield

Vice-Chairman: Pam Allan MP, Member for Wentworthville

Members: Ian Glachan MP, Member for Albury

Katrina Hodgkinson MP, Member for Burrinjuck

Richard Torbay MP, Member for Northern Tablelands

Barry Collier MP, Member for Miranda

¹ See Part 4 of the Act – The Public Accounts Committee.



Committee Secretariat

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Chairman's Foreword

The Auditor-General reports to Parliament each year on the results of audits of the accounts of agencies and the State's public accounts. Under the *Public Finance and Audit Act 1983*, the Committee has the power to follow-up Auditor General's reports.

The Committee selected a number of issues to follow up from the Auditor General's reports in late 2001 and early 2002. These matters included weaknesses in the internal controls of the Office of State Revenue's (OSR) administration of the First Home Owner Grant Scheme.

OSR's submission included the internal audit report, which identified the control weaknesses. At first glance, the report included a number of serious concerns, including the potential for unlimited loss of funds through fraud. The Committee, therefore, decided to progress to hearings.

At the hearings, however, the control risks did not appear to be as serious as first supposed. The Audit Office stated that these risks were mitigated by other factors, such as engaging well-known and reputable institutions to act as agents, penalties for fraudulent applications, and wide publicity of OSR's intention to audit applications against eligibility criteria.

Further, OSR appears to have diligently responded to the internal report, implementing all but one of the recommendations. OSR has argued that this final recommendation would not be cost effective to implement.

The Committee has made a number of recommendations, namely the need for:

- OSR to conduct risk assessments for projects; perform some retrospective audit compliance testing; and ensure agreements with outsourced service providers allow it to obtain audit assurance about their internal controls;
- the Audit Office to indicate the degree of risk to the Government of issues it reports to Parliament.

I would like to thank OSR and the Audit Office for cooperating with the Committee on this inquiry. I would also like to thank John Viljoen, who researched and drafted the report.

Joseph Tripodi MP
Chairman



Recommendations

1. OSR perform risk assessments for specific projects during the planning phase to ensure all risks are adequately identified, evaluated and addressed prior to the development and implementation phases of the project.

For each stage of the process, adequate records should be kept to satisfy independent audit requirements.

2. The Audit Office should indicate the nature and degree of risk to the Government of issues it reports to Parliament. This will enable users of its reports to better evaluate the potential impact and consequences for the Government and help determine what corrective action should be taken, if any.
3. OSR should ensure that all existing and future agreements with outsourced service providers include provisions for audit assurance to be obtained on the effectiveness of the internal controls operating within those organisations.
4. OSR should satisfy itself that there has been sufficient audit coverage of applications and grants received and paid prior to the upgrading of its compliance activities in 2001.



Chapter One

Introduction

Terms of Reference

Under its powers to follow-up Auditor-General's reports under section 57(1) of the *Public Finance and Audit Act 1983*, the Public Accounts Committee resolved to inquire into weaknesses in internal controls associated with the First Home Owner Grant Scheme. This matter was raised in the *Auditor-General's Report to Parliament 2001 – Volume 7*.

The inquiry sought to determine

- any internal control weaknesses associated with the scheme; and
- what audit assurance, if any, Treasury's Office of State Revenue (OSR) had obtained to satisfy itself that outsourced service providers, who maintain the database, have appropriate and effective controls.

If internal controls are not effective, the implication is that errors, fraud, or duplicate payments could occur.

Background

In 1998, the Commonwealth Government announced there would be a first home owner grant scheme to assist home ownership and offset the effect of the goods and services tax on the acquisition of a first home.

Under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, the States and Territories agreed to implement a First Home Owner Grant Scheme, administered by the States and Territories. Each State and Territory implemented its own legislation ensuring, through consultation, that eligibility for the grant was consistent with the principles outlined in the Intergovernmental Agreement and was uniform across Australia.²

The various jurisdictions needed to determine the best way to administer the system to ensure:

- uniformity across the country;
- cost effectiveness;
- high integrity; and
- quick delivery of grants to eligible applicants.

² NSW has the *First Home Owner Grant Act 2000*, assented to on 30 May 2000.



On this basis, the States decided that a joint computer system should be developed and built with input from each jurisdiction. It was also agreed that, as far as practicable, similar procedures should be developed so that applicants from different States would be subject to similar rules and regulations.

OSR was instrumental in involving financial institutions in the administration of the scheme because it saw benefits for the applicants and cost savings for the State Governments.

The Scheme commenced on 1 July 2000 and, according to OSR, worked very effectively from the outset. After approximately six months, OSR commissioned an internal audit of the system and its associated internal controls. This audit was to test the system's integrity and find out whether improvements could be made:

Mr ACHTERSTRAAT: Subsequently, the scheme got up and running on 1 July 2000. It worked very effectively. After it had been going for six months or a bit longer, we commissioned an internal audit report to see if there were ways we could improve the system and just to test the integrity of the system. The internal report was done by OSR. It took some time to do, mainly because there was toing and froing between the internal auditors and the business to determine wording and things like that.²

The internal audit commenced in April 2001 and the final audit report was issued in September 2001. The report identified a number of control weaknesses indicating the "potential for unlimited loss of grant funds through fraud, error and duplicate payments". It was this fact the Auditor-General reported to Parliament:

A recent internal audit review of the First Home Owner Grant Scheme has identified a number of areas where internal control procedures need to be strengthened to prevent the possible payment of fraudulent claims. OSR is currently reviewing the issues raised by internal audit. The scheme commenced on 1 July 2000 and payments to first home owners totalled \$314 million in 2000-01.³

As a result of the internal audit report, OSR took remedial action, accepting 34 of 35 recommendations, most of which have been implemented. Included amongst these actions has been the development and implementation of a comprehensive compliance audit program.⁴

² Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p23

³ Auditor-General, *Auditor-General's Report to Parliament 2001* – Volume 7, Sydney, p713

⁴ Internal Audit Review, First Home Owner Grant Scheme, Summary of Findings and Implementation Status



Chapter Two

The Risks

Planning for the Risks

OSR's written submission states that the following tasks were performed in the eight months leading up to the "immoveable commencement date" of 1 July 2000:

- development of a national system and associated infrastructure, including the computer system;
- establishment of an agency based network comprising diverse financial institutions;
- formulating and writing policy and legislation;
- development of compliance strategies; and
- preparation of procedures and training materials.⁵

Despite the significant amount of work that was necessary to get the scheme up and running in only eight months, it does not appear from the evidence that OSR performed a formal risk assessment as part of its initial planning process:

Mr COLLIER: Is a risk assessment performance part of the planning process? If so, when did this occur, who was it prepared by and what risks were identified?

Mr NEWBURY: I would say that whilst this was definitely part of the thinking of all jurisdictions going forward with this scheme, there was no formal risk assessment process in place at that time in any jurisdiction.⁶

According to the evidence, risk assessments were performed subsequently on an ad hoc basis, but this was done at a national level:

Mr NEWBURY: We now have [a risk assessment], for example, in New South Wales, but at that time it was probably more ad hoc.

Mr COLLIER: When was that done?

Mr NEWBURY: As part of the process of the system design, the system build, acceptance testing.

Mr COLLIER: Can you give us a date or an approximate time?

Mr NEWBURY: The system was designed from I think December 1999 through to about April 2000.

⁵ First Home Owner Grant Scheme submission to PAC, 8 August 2002

⁶ Director Client Services, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p25



Mr COLLIER: And that is when the risk assessment was done?

Mr NEWBURY: Yes.

Mr COLLIER: Who prepared that?

Mr NEWBURY: That would have been done by the officers on the national jurisdictional committee.

Mr COLLIER: At a national level it was done?

Mr NEWBURY: Yes.⁷

In a subsequent written submission to the Committee, OSR provided a number of documents supporting risk assessments performed at a national level during planning for the implementation of the scheme. These include:

- an extract from the First Home Owner Grant Scheme system analysis and design documentation, prepared in February 2000. The document identifies some risks associated with the development of the scheme's national computer system;
- a national contingency plan for the operation of the First Home Owner Grant Scheme, prepared in June 2000. This identifies seven key risks to the continuity of processing applications and payment of grants and proposes contingency solutions to address the risks;
- a briefing paper on national compliance and information requirements for the First Home Owner Grant Scheme, prepared in July 1999. This canvasses issues relating to the risk of non-compliance with scheme requirements; and
- a summary of senior counsel's advice on the first draft of the bill for the First Home Owner Grant Act 2000, dated 27 January 2000. The Victorian State Revenue Office on behalf of all jurisdictions sought this advice on a bill that was to be used as a national model for First Home Owner Grant legislation. The advice identified action to be taken to minimise the risk of successful litigation against a revenue officer or scheme administrator.

Whilst these risk assessments may have been of use to OSR in its development and implementation of the scheme within NSW, they did not necessarily identify, evaluate and address all risks specific to NSW and OSR in achieving the desired outcomes. A risk assessment performed during the planning phase may have identified risks, other than those identified at the national level, that were specific to NSW and OSR. Many of the risks identified by internal audit in its review of the system would have been raised by such a risk assessment.

⁷ *ibid.*, p25



Conclusion

Risk management is a generic tool that can be applied to most government activities. It should be applied to specific projects, particularly projects of this size, to assist with decisions or to manage recognised risks.

The Committee believes that applying these standard steps to implementing the Scheme would have involved the following:

- establishing the strategic, organisational and risk management context in which the rest of the process was to take place within OSR;
- establishing the criteria against which the risks were to be evaluated and defining the structure of the analysis;
- identifying the risks specific to OSR – what, why and how things could arise. This could have been used as the basis for further analysis;
- analysing these risks in terms of their likelihood and consequence in the context of existing controls. The analysis could have considered the range of potential consequences and how likely those consequences were to occur. The consequence and likelihood may have been combined to produce an estimated level of risk;
- evaluating the risks by comparing the estimated levels of risk against the pre-established criteria. This could have enabled OSR to rank the risks to identify management's priorities; and
- addressing the risks so that low priority risks may have been accepted and monitored, whilst for other risks, a specific management plan could have been implemented.

The Committee appreciates the limited time frame OSR had to implement the scheme within NSW. However, it believes the implementation process would have benefited if a risk assessment had been performed before the development and implementation of the system.

Recommendation 1

OSR perform risk assessments for specific projects during the planning phase to ensure all risks are adequately identified, evaluated and addressed prior to the development and implementation phases of the project.

For each stage of the process, adequate records should be kept to satisfy independent audit requirements.

The Risks

The main risks identified by the Audit Office and OSR include:

- payment to ineligible applicants;



- damage to the reputation of OSR;
- inefficient use of resources; and
- failure to provide adequate service levels to clients.

The Committee also raised these issues in evidence:

CHAIR: What risks, if any, does New South Wales carry in acting as the agent for the Commonwealth in this program?

Mr ACHTERSTRAAT: I guess the first question to ask is: Are we acting as the agent of the Commonwealth? There are a couple of views on that. The legislation is New South Wales legislation. The risks we have in implementing the legislation are, as the Audit Office has indicated, the risk to our reputation if we do not do it correctly. There is also a risk of overpayment. If payment is made to inappropriate people, there would be certainly a risk there. There are other risks of inefficient use of resources; there are risks of not providing a good service to clients, et cetera.

CHAIR: So reputation and financial risks are the two biggest risks?

Mr ACHTERSTRAAT: Absolutely.⁸

And:

Mr COLLIER: What were the risks identified?

Mr NEWBURY: The major risk was that we could pay grants to people who in fact were not entitled to receive a grant.⁹

Internal Audit Assessment of the Risks

Whilst the internal audit report described some of the control weaknesses as having the “potential for unlimited loss of grant funds through fraud, error and duplicate payments” this needs to be considered in context. The Audit Office believes that whilst there was potentially a high risk of fraud, error and duplicate payments, the chance of unlimited loss occurring was probably low.

The Hon. PAM ALLAN: In your opinion, were they potentially very high risks?

Mr LUMLEY: If it occurred to the extent that the report said, it could have been, but subsequent reviews by both the compliance people and ourselves did not disclose these risks as actually occurring or happening, so the incidents they were trying to portray were not actually happening in reality.

CHAIR: But there was a potential that there were high risks?

⁸ Executive Director, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p24

⁹ Director Client Services, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p25-26



Mr WHITFIELD: I think it is fair to say that there was the potential for high risk, but the likelihood of them occurring was probably low.¹⁰

CHAIR: Because of the mitigating controls?

Mr LUMLEY: Yes.¹¹

It appears that the internal audit report did not take account of inherent and other factors that mitigated the risk of fraud. These included:

- legislation that includes penalties for applicants who act fraudulently in obtaining grants;
- wide publicity of OSR's intention to carry out audits of applicants' compliance with rules and regulations governing eligibility for grants;
- a centralised computer system with built in controls that ensure certain criteria are met before applications are approved;
- agreements with the financial institutions that indemnify OSR in the event of wilful, wrongful acts or failure to take due care when processing applications; and
- the financial institutions, engaged as agents, were all well-known and reputable organisations such as banks and mortgage brokers.

The Committee discussed these mitigating factors in evidence:

CHAIR: OSR considered it essential that an audit review be undertaken to assure management of the integrity or otherwise of the program. The review was included in the internal audit plan for 2000-2001, which commenced in April 2001 with a final audit report being issued in September 2001. The report identified a number of control weaknesses which, if taken at face value, indicated the "potential for unlimited loss of grant funds through fraud, error and duplicate payments". Would you agree with these audit observations and implications?

Mr WHITE: I do not think the risk was as broad as they indicated because I do not think they took into account some of the mitigating inherent controls that are there in terms that there was a structure set up for the payment of the grants which involved legislation and it was publicised that if people incorrectly applied for grants there were penalties and it was also publicised that the Office of State Revenue was going to conduct audits of those grants, so in some way that would have mitigated the risk of fraud in that a lot of people would be unlikely to try and defraud the OSR if they knew that they could be caught. Also they had a computer system into which there were controls built in terms of duplicate payments and it required that certain criteria had to be met before an application could be approved and also they had an agreement with the agents that if they did wilful wrongful acts or neglected to do their duty they were indemnified, OSR was indemnified.¹²

¹⁰ Deputy Auditor-General, Audit Office of NSW, transcript of hearing, 24 October 2002, p21

¹¹ Assistant Auditor-General, Audit Office of NSW, transcript of hearing, 24 October 2002, p21

¹² Senior Audit Manager, Audit Office of NSW, transcript of hearing, 24 October 2002, p20



CHAIR: That was from the financial institutions?

Mr WHITE: Yes. So to a certain extent that sort of mitigates the risk in that financial institutions are unlikely to--

CHAIR: Take that risk themselves?

Mr WHITE: Yes...The other thing too is that the people who were engaged as agents were well known, reputable, like banks and mortgage brokers, so there is a sort of inherent control there.¹³

And:

The Hon. PAM ALLAN: Why were the potentially very high risks not subject to some form of mitigation strategy or internal control checks?

Mr ACHTERSTRAAT: Again, we agreed that the 34 recommendations would in fact help us in the operation of the system. To say that none of the risks had been addressed before that is probably drawing a long bow. We believe that the risks did have mitigating strategies during the period before the audit, but, as it was said in the audit report, some of them could be tightened up more.

We do not necessarily accept all the statements, the comments and implications in the report, as is the case in a number of audit reports we get. We do not necessarily, at the end of the day, agree with all the conclusions, but we decide which of the recommendations to endorse.¹⁴

The Committee believes it would have been helpful to users of the Auditor-General's Report to Parliament if it had indicated the degree of risk the Audit Office believed the Government faced from the internal control weaknesses identified in the internal audit report. Some risk categories, for example, are outlined in Standards Australia's *Guidelines for Managing Risk in the Australian and New Zealand Public Sector*.¹⁵

In its report on the NSW Grains Board, the Committee identified the importance of explaining the significance and financial implications of issues raised in Audit Office reports to Parliament (pp 59-60).¹⁶ The Committee also discussed the value of risk reporting (pp 64-67).¹⁷

¹³ Senior Audit Manager, Audit Office of NSW, transcript of hearing, 24 October 2002, p20

¹⁴ Executive Director, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p26

¹⁵ Standards Australia, *Guidelines for Managing Risk in the Australian and New Zealand Public Sector*, pp 26-30

¹⁶ Public Accounts Committee, *Inquiry into the Collapse of the NSW Grains Board.*; pp 59-60

¹⁷ *ibid.*; pp 64-67



Recommendation 2

The Audit Office should indicate the nature and degree of risk to the Government of issues it reports to Parliament. This will enable users of its reports to better evaluate the potential impact and consequences for the Government and help determine what corrective action should be taken, if any.

Conclusion

The internal audit report correctly identified areas where controls could be improved, as evidenced by the fact that OSR accepted 34 of its 35 recommendations, of which 29 have been implemented.

Mr ACHTERSTRAAT: Many of the recommendations that subsequently came out were in fact adopted during the course of the audit, so we did not necessarily wait until the end of the audit. At the end of the day, of the 35 recommendations, 34 were accepted by us. 29 have been fully implemented now and there is action on the way on some of the others.¹⁸

Because the internal audit report made no mention of the mitigating effects of inherent and other controls, it probably overstated or gave the wrong impression of the likelihood of fraud, error or duplicate payments occurring. The risks were not that great:

CHAIR: So in essence that internal report overstated the risks that were involved?

Mr WHITE: I think the report was fair in that those measures should have been taken, but I think it is probably a bit far to go to say that there was potential for major fraud because if there had been major fraud I am pretty sure it would have been well known to most people anyway...¹⁹

Mr LUMLEY: We thought it was a worst case scenario, the assessment, and probably the weight given to the mitigating controls did not come through in the assessment. As I say, it was a worst case scenario sort of a greenfield's approach without perhaps due consideration being given to some of these mitigating controls which Geoff enumerated.²⁰

¹⁸ Executive Director, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p24

¹⁹ Senior Audit manager, Audit Office of NSW, transcript of hearing, 24 October 2002, pp20-21

²⁰ Assistant Auditor-General, Audit Office of NSW, transcript of hearing, 24 October 2002, pp20-21



Chapter Three

Remedial Action

The Internal Audit Report

The report identified 18 risks, and detailed weaknesses observed in mitigation strategies employed by OSR. It made separate recommendations to remedy each weakness. In its submission, OSR provided the Committee with a copy of the report, which also included proposed actions and their status. The following tables summarise the issues raised in the report that the Committee considers critical.

Risk 1: Fraudulent Misappropriation of Grant Funds

Weakness observed	Implication	Recommendation	Proposed action	Status
No control over processing of applications by financial institutions	Potential for unlimited loss of funds through fraud	Audit of financial institutions needs to be undertaken	Develop risk profile and audit program	Implemented
Poor segregation of duties for processing applications in OSR	Potential for unlimited loss of funds through fraud and error	Extend time for processing applications to allow some checking prior to payment	Processing time extended to allow random checks	Implemented
No reconciliation of payment reports	Loss of funds through fraud	All payment reports to be reconciled to amount authorised for payment	All reports reconciled daily	Implemented
No monthly reconciliation of FHOGS database and general ledger	Potential fraud and inaccurate reporting	Monthly reconciliation to ensure payments are not generated outside the system	Monthly reconciliation performed	Implemented
Current compliance program not comprehensive	Fraud and errors may go undetected	Develop compliance audit program targeting potential high risks	Risk profile and audit program developed	Implemented
Inadequate checking of interstate interests in property ownership	Fraud and errors may go undetected	Check interstate ownership for all applications selected in compliance audit program	Not agreed Implementation not cost effective	Not implemented

Source: OSR submission



Risk 2: System Security Controls

Weakness observed	Implication	Recommendation	Proposed action	Status
Staff in FHOGS unit have access to reset passwords & end user sessions	Dummy users can be set up and fraudulent payments processed	Control of access to FHOGS should be changed	Information Security to control new user access. Help desk to reset passwords	Due for implementation 31/10/02
Financial Institution user requests for password reset not authenticated and evidence of shared login Ids	Unauthorised use of login ID could occur. Fraud may occur	All users to be authenticated by "date of birth field"	Currently being developed	Due for implementation 30/9/02

Source: OSR submission

Risk 6: Contracts fail to cover OSR's interests

Weakness observed	Implication	Recommendation	Proposed action	Status
Uncertainty exists as to the adequacy and legality of contractual arrangements with service providers and between the States	Interim technology contract; Telstra Service Agreement; Memo of Understanding may not cover OSR's interests	Obtain formal legal advice on the adequacy of contractual arrangements	Obtain Crown Solicitor's advice on Deed of Arrangement with Financial Institutions & Memo of Understanding between States Obtain advice on Spherion and Telstra contracts	Advice obtained Awaiting advice

Source: OSR submission

The Committee is pleased to note that all but one of the recommendations have been accepted and implemented or are currently being resolved.

Recommendation Not Accepted

OSR did not accept one recommendation. This was under risk 1, namely that "interstate interests in property ownership should be checked for all applications selected for review as part of the compliance audit program." OSR has argued it would not be cost effective. Instead, OSR has adopted a risk-based strategy to check interstate ownership, whereby only high-risk applications are checked.



To date there has not been a single case where interstate ownership has been identified that has required repayment of a grant:

CHAIR: In relation to the process of checking interstate interests in property ownership, recommendation 6 in the report recommends that interstate ownership be checked for all applications selected for review as part of the compliance audit program. This recommendation was not accepted, as implementation would not be cost effective. Could you explain why it would not be cost effective and whether there are any alternative strategies that may mitigate this risk?

Mr ACHTERSTRAAT: The recommendation was that all interstate ownership be checked. The system, because it is a national system, automatically checks whether somebody has been paid a grant before in other States. As to whether someone who has owned a property before 1 July 2000, the recommendation was there that we were to check the land titles records in every jurisdiction. The cost of doing that: There is a monetary cost and a time cost. From memory, they have averaged it out, and I am not sure of the figure, Mr Chairman, but I think it is about \$6 for every check. If you multiply that by eight States it is \$48 per application. We do not check every case of interstate ownership, but on occasion where the risk warrants it we are in a position where we can check interstate ownership if we think there is a high risk. I think our experience is that when there was some checking done on a random basis interstate the results did not indicate a very high risk. That is my understanding.²¹

Mr WITHERS: There has not been one grant where we have asked for repayment based on identification of a prior ownership in another State.²²

On the evidence, it appears the risk management approach is satisfactory in this case.

Contractual Issues

The Scheme operates under a web of supporting agreements between the States, the Commonwealth, and the outsourced service providers, Telstra and Spherion. The internal audit report identified a number of concerns associated with the agreements. These concerns include uncertainty as to their adequacy and legality.

The Audit Office shared these concerns and stressed the need for the agreements to allow for the Audit Office to obtain sufficient audit assurance about the database. In particular, that appropriate controls are in place, are operating effectively and continuously, and have not been breached:

Mr COLLIER: Looking ahead, are you satisfied that the controls that you have put in place will provide the assurance needed that fraud, error or even duplicate payments will not occur or remain undetected in the future?

²¹ Executive Director, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, pp31-32

²² Director Compliance Division, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002., pp31-32



Mr WHITE: Yes, certainly they will, but they do need to address the other issues like getting some assurance from the people who operate the database. They need to have a contract that allows for audit of the database and the people who actually operate the system. Until they get that there is still going to need to be testing done to ensure that controls have not been breached.²³

And:

The Hon. PAM ALLAN: Recommendations 19 and 20 of the internal audit report suggest that legal advice be sought with regard to the deed of arrangement between the OSR and financial institutions; a memorandum of understanding between jurisdictions; support services agreement and Telstra agreement to ensure OSR's interests are protected legally and operationally. Have you sighted any of these advices or made any assessment of their impact on the organisation and your audit?

Mr WHITE: I have sighted all of those except the one between Telstra and the Victorians, I think it is, and they basically come to the same conclusions as us in terms of the service agreement, that the contract that was entered into was lacking in terms of its ability for people to audit the system, to get external comfort that the system was working correctly. The memorandum of understanding did not cause us too many problems because basically, from what I read of the Crown Solicitor's opinion, it is not legally binding until such time as it is signed, but certainly the ones I read supported our findings in terms that when they renegotiate these agreements there should be proper procedures put in there for audit and things like protection of intellectual property and that type of thing.²⁴

The Audit Office concerns arise, in part, from the requirements of Auditing Standard *AUS 404 "Audit Implications Relating to Entities Using a Service Entity"*.

A legal requirement of this standard is that:

The auditor [in this case the Audit Office] should assess the effect that a service entity [here the outsourced service provider] has on audit risk to enable the auditor to plan and develop an effective audit approach.

This applies:

Where transactions that affect the financial report of the user [NSW Treasury, OSR] flow through an internal control structure which is, at least in part, legally, physically and operationally separate from the user, some or all of the [audit] evidence to which the user auditor [Audit Office] ordinarily applies tests of controls and substantive procedures may be under the control of the service entity [outsourced service provider]. For the user auditor to draw reasonable conclusions about the transactions and in some cases the resultant balances, which flow through the internal control structure of the service entity, it may be necessary to obtain audit evidence from the service entity or to have access to the records of the service

²³ Senior Audit Manager, Audit Office of NSW, transcript of hearing, 24 October 2002., p21

²⁴ *ibid.*, p22



entity. In such circumstances the user auditor may find it effective, or some cases necessary, to consider the internal control structure of the service entity.²⁵

The standard and the law further require that:

...the user auditor should obtain audit evidence through the performance of tests of control to support any assessment of control risk which is less than high.

This evidence, as it relates to the service entity, would be obtained by one or a combination of the following:

- (a) Obtaining from the service entity auditor a report on the tests of control performed on the internal control structure of the service entity and the results thereof;
- (b) Requesting the service entity auditor to conduct agreed upon procedures; or
- (c) Conducting audit procedures at the service entity.²⁶

Based on the evidence obtained, the Audit Office can then evaluate whether the internal controls are designed and are operating as contemplated.

OSR for its part has sought advice from the Crown Solicitor on a number of occasions on each of the agreements. It is acting in line with these recommendations and is in the process of ensuring the concerns of the Crown Solicitor, the Audit Office and Internal Audit are being addressed through the negotiation or renegotiation of the agreements.

Conclusion

OSR appears to have taken adequate remedial action or is in the process of addressing the issues raised in the internal audit report. The Committee is concerned, however, that all agreements with outsourced service providers should include provisions for audit assurance to be obtained on the effectiveness of the internal controls operating within those organisations.

Recommendation 3

OSR should ensure that all existing and future agreements with outsourced service providers include provisions for audit assurance to be obtained on the effectiveness of the internal controls operating within those organisations.

²⁵ Auditing Standard, AUS 404 "Audit Implications Relating to Entities Using a Service Entity"

²⁶ *ibid*



Chapter Four

Checking Past Payments

The Audit Compliance Program

The internal audit report was issued 15 months after the scheme commenced and action to address the potential risks identified was subsequently taken on a progressive basis. Therefore, the Committee wanted to satisfy itself that OSR had carried out procedures retrospectively to ensure that fraud, error or duplicate payments had not occurred during that period.

Whilst some compliance work was performed during this period, OSR does not appear to have done substantial retrospective work using the audit compliance program, developed after the internal audit report was issued.

CHAIR: Has there been any retrospective work done on determining whether there has been fraud or other irregularities?

Mr ACHTERSTRAAT: Clearly, what we have done is put in a comprehensive compliance program.²⁷

Mr WITHERS: In the early days of the compliance activities, we focused very much on looking at individual claims for grants, and we moved later on to look at a number of financial institutions and controls that were operating there, and that is continuing. To date, the examinations we have carried out with the financial institutions have satisfied us that their controls are reasonable and that there is no major opportunity for fraud within those organisations we have looked at, and that has given us a lot more confidence than we might have had before. I think that is also backed up by the fact that as we have looked at individual grant applications, we have not looked at them particularly, I gather, as to whether they are lodged through a financial institution or lodged directly with us, but the rate of non-compliance is quite low and it is no higher with the financial institutions than it is with the applications lodged directly with us.²⁸

The Committee would like OSR to obtain sufficient assurance that fraudulent and duplicate payments did not occur during the period before the compliance audit program started.

²⁷ Executive Director, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, pp26-27

²⁸ Director Compliance Division, Office of State Revenue, transcript of hearing, 24 October 2002, p26-27



Recommendation 4

OSR should satisfy itself that there has been sufficient audit coverage of applications and grants received and paid prior to the upgrading of its compliance activities in 2001.

Since the compliance audit program was developed and implemented, there has been little evidence of fraud, error or duplicate payments occurring. Both OSR and the Audit Office believe that the controls now in place will provide the assurance needed that fraud, error and duplicate payments will not occur or remain undetected in the future:

The Hon. PAM ALLAN: Are you satisfied that the controls now in place will provide the assurance needed that fraud, error or duplicate payments will not occur or remain undetected in the future?

Mr ACHTERSTRAAT: You can never give a blanket assurance that there will never be fraud or never be anyone speeding or anything like that. We are satisfied that the controls we have in place are appropriate to cover all the risks and that we will be able to detect risks or any fraud. So we are satisfied with the controls we have put in place.²⁹

Mr UNDERHILL: The recommendations have been implemented along the lines of the action plan that we negotiated with the clients through OSR and we are happy with the progress that has been made on implementation of those audit recommendations.³⁰

And:

CHAIR: Now the internal audit report was issued 15 months after the scheme started and action to address the potential risks has been taken on a progressive basis. Do you believe that the delay in implementing these subsequent controls did cost or will potentially cost the Government?

Mr LUMLEY: Well, that would not appear to be the case on the basis of our reviews and the reviews of the compliance people from OSR. As I say, the incidents were not coming through as problems being there, so on the basis of that you would have to say no.³¹

The Hon. PAM ALLAN: Has the Audit Office tested the controls implemented since the audit report was issued to determine whether they are operating effectively and continuously?

Mr WHITE: Yes, we have tested those, those controls that have been implemented in the last financial year, and they were the ones mainly dealing with compliance

²⁹ Executive Director, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p27

³⁰ Deputy Director, Audit and Revenue Support, Office of State Revenue, NSW Treasury, transcript of hearing, 24 October 2002, p27

³¹ Assistant Auditor-General, Audit Office of NSW, transcript of hearing, 24 October 2002, p21



activities because a lot of the other ones have only been implemented since 30 June 2002, so we have looked at the compliance activities certainly, but a lot of the other ones require renegotiation of agreements by other States and things of that nature.

Mr COLLIER: Looking ahead, are you satisfied that the controls that [OSR has] put in place will provide the assurance needed that fraud, error or even duplicate payments will not occur or remain undetected in the future?

Mr WHITE: Yes, certainly they will, but they do need to address the other issues like getting some assurance from the people who operate the database. They need to have a contract that allows for audit of the database and the people who actually operate the system. Until they get that there is still going to need to be testing done to ensure that controls have not been breached.³²

Conclusion

From the evidence it appears that fraud, error or duplicate payments are unlikely to be significant and that there are adequate controls now in place to either prevent or detect any instances that may occur.

³² Senior Audit Manager, Audit Office of NSW, transcript of hearing, 24 October 2002, p21



Appendix A

Submissions and Documents Received by the Committee

No.	Submitted or Tabled by:	Subject
1.	The Honourable Michael Egan , Treasurer	First Home Owner Grant Scheme submission to PAC, 8 August 2002.
2.	The Honourable Michael Egan , Treasurer	First Home Owner Grant Scheme "Factsheet", January 2002.
3.	The Honourable Michael Egan , Treasurer	Internal Audit Review, First Home Owner Grant Scheme, Summary of Findings and Implementation Status.
4.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	First Home Owner Grant Scheme, Report on Audit Results for Financial Institutions.
5.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	Copy of typical letter sent to a financial institution after an audit.
6.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	Extract from First Home Owner Grant Scheme system analysis and design documentation, February 2000. Identifies risks associated with development of the scheme's national computer system.
7.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	National contingency plan for operation of the First Home Owner Grant Scheme, June 2000. Identifies seven key risks to continuity of processing applications & payment of grants & proposes contingency solutions to address risks.
8.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	Briefing paper on national compliance and information requirements for the First Home Owner Grant Scheme, July 1999. Canvasses risks of non-compliance with scheme requirements.



No.	Submitted or Tabled by:	Subject
9.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	Summary of senior counsel's advice on first draft of bill for First Home Owner Grant Act 2000, 27 January 2000. Victorian State Revenue Office sought advice on behalf of all jurisdictions on a bill for use as national model for First Home Owner Grant legislation. Advice identifies actions to minimise risk of successful litigation against revenue officers or scheme administrators.
10.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	Crown Solicitor's advisings relating to Memorandum of Understanding between Commissioners of State Revenue for the various State & Territory jurisdictions, 7 March 2000; 23 July 2002; 21 August 2002.
11.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	Crown Solicitor's advisings relating to Deed of Arrangement between Commissioners of State Revenue for the various State & Territory jurisdictions and participating financial institutions, 22 May 2000; 5 June 2002.
12.	Mr Peter Achterstraat , Chief Commissioner of State Revenue, Office of State Revenue, NSW Treasury	Crown Solicitor's advisings relating to system application support services between the Victorian State Revenue Office and Spherion, 16 August 2002.

**Appendix B****List of Witnesses Appearing Before the Committee**

Witness	Position and Organisation	Hearing Date
Mr Anthony Thomas Whitfield	Deputy Auditor-General, Audit Office of New South Wales.	24 October, 2002
Mr Eric Lumley	Assistant Auditor-General, Audit Office of New South Wales.	24 October, 2002
Mr Geoffrey Paul White	Senior Audit Manager, Audit Office of New South Wales.	24 October, 2002
Mr Peter Charles Achterstraat	Executive Director, Office of State Revenue.	24 October, 2002
Mr Michael Geoffrey Kennedy	Chief Information Officer, Office of State Revenue.	24 October, 2002
Mr Edward John Withers	Director of Compliance Division, Office of State Revenue.	24 October, 2002
Mr Geoffrey James Underhill	Deputy Director, Audit and Revenue Support, Office of State Revenue.	24 October, 2002
Mr Anthony John Newbury	Director Client Services, Office of State Revenue.	24 October, 2002