

*AEC*

*Funding &  
Disclosure  
compliance  
review  
function  
discussion  
paper*

*Australian Electoral  
Commission*

*Performance audit of  
the Disclosure  
Compliance Function*

*November 2012*



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## ***Disclaimer***

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# *Executive summary*

## *Introduction and scope*

The Australian Electoral Commission (AEC) engaged Mr Ron McLeod AM to undertake a review of the compliance review function conducted within the Funding and Disclosure (FAD) section of the AEC. PwC was subsequently engaged to conduct this performance audit to assess the efficiency and effectiveness of the AEC's conduct of compliance reviews, including:

- A review and evaluation of internal policies and guidance material on Part XX of the Electoral Act regarding the compliance review function, such as:
  - Processes and procedures, including risk assessment frameworks which are used to guide decisions regarding work programs;
  - Audit methodologies, including the depth of testing performed; and
  - Past internal audit reports and recommendations.
- An examination of the appropriateness of the scope and focus of compliance reviews; and
- An examination of whether the current workforce model in relation to disclosure compliance is appropriate to achieve efficient and effective compliance review coverage, and how it can be improved.

This performance audit was intended to complement the broader review of compliance review activities undertaken by Mr McLeod.

In conducting this performance audit we have assessed the following four key areas in relation to the compliance review function:

1. Governance of the compliance review function, including the strategic direction, establishment of objectives and monitoring of performance
2. Risk management practices in relation to the compliance review function as well as the application of risk assessment practices in targeting and conducting compliance review activity
3. The audit methodology applied in the execution of compliance review activity
4. Human resource management within the compliance review function to support the overall operations of the team and achievement of objectives.

Our findings and proposed solutions against each of these key areas are summarised below.

## *Overview of observations and proposed solutions*

The performance audit conducted by PwC identified issues and recommendations in relation to the following key aspects of the AEC's compliance review function:

### *Governance*

There needs to be a clearer definition of strategic direction and enhanced Executive support than has been provided to the compliance review function for a number of years, which has allowed the area to operate too much in isolation. This is partly due to the function being ancillary to core responsibilities of the AEC such as conducting federal elections and referendums, and maintaining the Commonwealth electoral roll.

There is a need to establish an effective governance framework to ensure objectives are communicated and being achieved, the oversight of outcomes, resource allocation and monitoring of performance. The governance issues are partly evidenced by the number of previous audit recommendations relating to the function that have been partially implemented and have not been subject to an effective follow-up process to ensure the effectiveness of actions and confirm the progress achieved.

There exists a need for stronger engagement and representation at the Executive level which will involve dedicated senior leadership for the function, strategic alignment with other areas of the AEC, closer oversight of objectives, and increased accountability.

#### *Risk management framework*

There is no risk management framework encapsulating both the overall compliance review function and a risk-based sampling methodology to ensure efficient and effective coverage of political parties and associated entities. Appendix B includes previously reported Internal Audit findings in relation to a risk assessment methodology and despite a management focus on improving the processes within the team there has been little progress on embedding a risk assessment methodology into the compliance review function. The absence of a risk management framework has resulted in the compliance function being reactive and reliant on the existing corporate knowledge of its management team with risks being identified and managed in a haphazard manner.

Political parties and associated entities are subject to coverage on a cyclical basis through a routine schedule which results in the selection process not being risk-based. This approach to compliance review coverage reduces the need to apply professional judgement and can result in staff time being unnecessarily allocated to compliance review activities that are less risky whilst providing insufficient attention to higher risk organisations and situations.

The risk management framework needs to be integral to the AEC's approach to conducting compliance reviews as a key input for decision-making, and determining the appropriate allocation of resources and methodology. An effective risk management framework will assist with identifying and establishing a range of compliance review approaches to present an element of unpredictability to the process. In summary terms, potential approaches should involve:

- Test checking the accuracy of a sample of annual disclosure returns following improvements to the existing compliance methodology;
- Use of specialists and appropriate expertise to more forensically research books, records and other available material to get "behind the scenes" and identify potential misstatements by applying sensitivity tests in a more structured manner;
- Random checking a sample of organisations selected on the basis of potential disclosure misstatements, professional judgement and other intelligence gathering techniques; and
- Limited review of a sample of annual disclosure returns that are considered lower risk involving a reasonableness review of the information provided prior to publication on the AEC web site.

#### *Audit methodology*

The compliance review methodology requires improvement across key phases of the process including planning, fieldwork, reporting, quality assurance and documentation. The function would also benefit from access to specialist investigative services to provide capacity and directly relevant expertise for the conduct of compliance investigations.

The existing methodology is focussed on detailed checking of the accuracy of all information already provided by the political parties and associated entities in their annual disclosure returns. Efficiencies could be gained by testing a smaller sample of transactions in this manner, and directing the additional time available towards the risk of understatement to ensure that the information presented is not missing items that require disclosure in the annual return.

Testing of completeness is being performed inconsistently and there is inadequate evidence or appropriate documentation to support whether these procedures are being adequately performed.

#### *Human resource management*

The compliance team has encountered challenges with attracting, training and retaining suitably experienced or qualified staff with the requisite skills required to perform roles during the key phases of the compliance review process. The function would benefit from supplementation of more contemporary

audit and financial accounting skills, experience and qualifications in conjunction with some 'fresh thinking' and investigation proficiencies.

Prior to approaching the market for these types of staff resources, a comprehensive workforce planning process of the compliance function needs should be conducted that will inform a strategy to attract, recruit, train and retain the optimal staffing mix with suitable qualifications, experience, skills.

The function also requires access to appropriate subject matter specialists and technical expertise to provide assistance across certain aspects of the scheme including the provision of in-house training. Assignments that utilise external specialists should involve working directly with a compliance team member(s) to facilitate knowledge transfer as an additional training opportunity to build on lessons learned and improve the existing methodology.

This report includes a summary of the conclusions outlined above as well as a number of detailed recommendations aimed at improving the future performance of the compliance function.

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# 1 *Background and approach*

## 1.1 *Background*

The funding and disclosure provisions of the *Commonwealth Electoral Act 1918* (the Electoral Act) have been in operation since the 1984 election, but their form has changed from the time they were introduced. The provisions of the Electoral Act have two main components which are contained in Part XX:

- Public funding of election campaigns; and
- Disclosure of certain financial details by candidates, registered political parties and other persons (third parties) and groups (return forms are submitted to the AEC).

Registered political parties and their State or Territory branches and associated entities are required to lodge an annual return with the AEC. This provides information about amounts received and paid during the financial year and debts outstanding at 30 June. Returns to the AEC must show:

- the total value of receipts during the financial year;
- the total value of payments during the financial year;
- the total value of debts as at 30 June; and
- all individual receipts above the disclosure threshold, including:
  - the amount or value of the receipt; and
  - the name and address of the person/body from whom the receipt was provided

The AEC requires that the parties and entities classify each receipt over the threshold as a “donation” or “other receipt”. Donors must disclose gifts totalling more than the disclosure threshold made to a registered political party or associated entity.

The financial disclosure scheme was amended with effect from 8 December 2005 to increase the threshold to ‘more than \$10,000’. This amount is indexed with effect from 1 July each year based on movements in the consumer price index. The current disclosure threshold from 1 July 2012 to 30 June 2013 is ‘more than \$12 100’.

The objective of compliance reviews performed by the AEC is to issue an opinion, based on the records examined, on whether the annual return lodged by the party with the AEC represents a complete and accurate reflection of the transactions of the party in accordance with the Electoral Act. The compliance review team develop an annual plan of compliance activity that is designed to provide coverage of political parties and their associated entities. The annual work plan is currently based on the hours available for staff to perform reviews and aims to cover each political party and their associated entities once every three years.

## 1.2 *Approach*

In line with the terms of reference outlined by the AEC in its initial request for a performance audit of the compliance review function, and through consultation with Mr Ron McLeod AM, PwC identified four main areas of focus, which are reflected in the structure of this report:

- **Governance** – we performed an evaluation of the current assignment of compliance review related functions and responsibilities within the AEC and how these could be better aligned with core components of an effective governance structure.
- **Risk Management** – involved assessing whether the existing approach to the assessment of risk enables the compliance function to operate efficiently and effectively whilst addressing intentions of the Electoral Act.
- **Audit Methodology** – an assessment of the compliance review methodology was performed by gaining an understanding of the testing approach, completing a walkthrough of systems used, and reviewing a sample of compliance review work paper files completed during 2012. This was conducted across each of the three teams to assess the appropriateness and consistency of the scope and approaches applied in practice across the three teams.

- ***Human Resource Management*** – an assessment of whether the current workforce model and staffing is appropriate to achieve efficient and effective compliance review coverage whilst having regard to the background challenges and risks associated with the function.

Across each of these areas, our approach was split into three phases: research and review of existing documentation; consultation with key stakeholders and audit fieldwork; analysis and development of recommendations.

## 2 Observations

### 2.1 Governance

#### Background

Governance can be defined as:

*“...the set of responsibilities and practices, policies and procedures, exercised by an agency’s executive, to provide strategic direction, ensure objectives are achieved, manage risks and use resources responsibly and with accountability”*

(Building Better Governance, 2008)

In order to achieve these objectives, the key components of governance in the compliance review function need to be properly identified and appropriately implemented to ensure their effective ongoing operation. These include information and communication, risk management and the methodology framework which are discussed in further detail in subsequent sections of this report.

The Funding and Disclosure team have operated under various reporting lines and structures over the past decade. Consultation with staff indicated that there is not a ‘home’ for the compliance review function within the AEC that aligns neatly with the various objectives of other sections of the AEC. The current responsibility for Executive oversight of the compliance review function rests with the Chief Legal Officer, who reports to the Deputy Electoral Commissioner.

#### Observations

##### Strategic direction

From our discussions with members of the compliance review team there is limited understanding of the compliance review function’s overarching objectives and goals. This may be due in part to the following contributing factors:

- A lack of understanding of the linkages between the AEC’s strategic objectives (as documented in the AEC’s Strategic Plan 2009-2014, AEC risk management plan,<sup>1</sup> AEC fraud control plan etc) and the role of the compliance review function. It is acknowledged that the outcome of having ‘informed Australian’s through the provision of information services on electoral matters’<sup>2</sup> is relevant to the compliance review function, however, there is not a strong understanding or appreciation of this alignment within the compliance review team. The function is ancillary to core responsibilities of the AEC such as conducting federal elections and referendums, and maintaining the Commonwealth electoral roll.
- The link between the compliance review function and the AEC’s objective of having an informed community is weakened by the delay in the disclosure process (occurs only once per annum) and the level of exposure that is applied to the information once it is published. In essence, the compliance review process is not an active real time regulatory function.
- It is acknowledged that there is limited exposure to the AEC Executive as the compliance review function within the FAD section is without close practical linkages to the rest of the branch that it resides in (Legal and Compliance). The lack of linkages within the Legal and Compliance branch is related to the specialised nature of the functions managed by the branch (legal, ministerial and funding and disclosure).

The compliance review team appear to operate as a discrete function within the AEC with little direct oversight from the rest of the AEC other than their branch head, the Chief Legal Officer who is responsible for a range of other legal and related matters across the organisation. As a result, the compliance review team has now defined its own purpose to guide its administration of the legislation.

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<sup>1</sup> Noting that previous internal audit reports have identified the high risks associated with FAD activities.

<sup>2</sup> This statement was selected due to its relevance to the compliance function and was obtained from Program 1.3 of the AEC’s 2012-13 Portfolio Budget statements.

Examples provided to us during the review included:

- Lack of direction being provided to the compliance review function, there is formal approval of the annual compliance activities being conducted but this is rarely challenged; and
- Management reports and compliance review results tend to remain within the area and are not subject to review or scrutiny elsewhere in the AEC (final reports or correspondence are generally not reviewed outside of the section).

On occasions, the Director responsible for the compliance review function also assists in other roles beyond the area's day-to-day operational activities. This may involve responding to parliamentary questions, assessing the impact of legislative change and providing policy advice.

### ***Ensure objectives are achieved***

The objectives of the compliance reviews are focused on achieving coverage of organisations as documented in the Compliance Review plan. This is based on the premise that a broad coverage of organisations will increase the likelihood that they lodge annual returns on a timely basis. In the absence of higher level objectives the compliance review function has defined its own purpose to guide its administration of the legislation as follows:

*Helping guard against corruption by requiring those involved in the political process to publicly disclose relevant financial dealings.*

The methodology section of this report expands on the objectives of individual compliance reviews and the current narrow focus of these activities.

### ***Manage risk***

There is no risk management framework encapsulating both the overall compliance review function and a risk-based sampling methodology to ensure efficient and effective coverage of political parties and associated entities. Risk management should also be an integral component of the compliance review methodology, in particular, using risk as a driver for compliance review activity. This is discussed in more detail below under the risk management framework section (2.2) of this report.

### ***Ensuring resources are deployed appropriately***

Resources within the compliance review function are being managed by input rather than output. That is, the level of activity and work performed is defined by the level of resources available, rather than working towards the achievement of objectives or management of risk. This is evidenced by the annual work plan which is defined by the number of staff hours that can be deployed as opposed to the objectives that the compliance reviews are seeking to achieve.

### ***Provide assurance that business is being conducted properly***

The status of previous Internal Audit (IA) recommendations relating to the compliance review function has been assessed and is included in Appendix B to this report. The majority of previously reported findings are not completely closed, suggesting a break down in the organisational controls over follow up of the recommendations and the assurance being provided to the AEC Executive that previously raised issues have been resolved. In addition, there has been no independent assurance activity performed over the compliance review function in the last five years. Quality assurance mechanisms do exist within the compliance review area and their effectiveness is covered within the methodology section of this report.

## **Recommendations**

R1. The AEC Executive should ensure that the compliance review team has an established and ratified agreed set of strategic goals and objectives for the function. This will require the alignment of the strategic goals and objectives of compliance reviews to the overall objectives of the AEC.

R2. Consistent with Mr McLeod's Recommendation 3 Executive oversight and guidance of the compliance review function should be strengthened by a dedicated branch head to ensure that issues detailed in this report are appropriately dealt with and receive due attention among the competing priorities of the AEC whilst committing the necessary support and leadership to the area.

## **2.2 Risk Management**

### **2.2.1 Overview of risk management**

Managing risk is an important aspect of achieving organisational objectives. Risk management seeks to direct and control an organisation's activities that relate to risk, and in doing so to increase the ability of the organisation to achieve those objectives.

A failure to establish and apply a risk assessment framework comprehensively and consistently can result in compliance review resources not being targeted at the higher risk areas. Ideally, the compliance function should be based on a comprehensive risk assessment. If the risk assessment process has been correctly applied, the organisations that are subject to compliance reviews will generally be those deemed as higher risk, and as such those warranting the most attention. For this reason, it is particularly important that experienced, appropriately skilled and proficient staff should be assigned to overseeing the compliance function's risk management framework including the risk-based sample selection process.

An effective risk management framework will assist with identifying and establishing a range of compliance review approaches to present an element of unpredictability for federally registered political parties and their state branches and associated entities that are required to lodge annual disclosure returns. In summary terms, potential approaches could involve:

- Test checking the accuracy of a sample of annual disclosure returns following improvements to the existing compliance methodology (refer to Section 2.3 of this report);
- Use of specialists and appropriate expertise to more forensically research books, records and other available material to get "behind the scenes" and identify potential misstatements by applying sensibility tests in a more structured manner. These resources can also assist with the identification of situations that may indicate "reasonable grounds" under section 316(3) for believing that the person on whom the notice would be issued can provide evidence of a contravention or possible contravention;
- Random checking a sample of organisations selected on the basis of potential disclosure misstatements, professional judgement and other intelligence gathering techniques to maintain unpredictability;<sup>3</sup> and
- Limited review of a sample of annual disclosure returns that are considered lower risk involving a reasonableness review of the information provided prior to publication on the AEC web site.

### **2.2.2 Compliance function's risk management approach**

Previous internal audit reports have highlighted the compliance function performed under Part XX of the Electoral Act as a higher-risk activity for the AEC.

An essential element to ensure the compliance function operates effectively and in accordance with the Electoral Act is a robust risk management framework which encompasses two major themes:

- A. Whole of compliance function risk management framework; and
- B. Risk-based sampling processes to inform the compliance function.

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<sup>3</sup> The random checking process would build on the methodology applied in a standard compliance review under section 316(2A) which involves access to a range of documents and records. This process would be conducted onsite with the organisation and include a more thorough review of documentation and interviews with Office Holders.

### 2.2.3 Whole of compliance function risk management framework

#### Observations

Currently, there is no risk management framework established for the compliance function to define how risks are to be identified and managed. There has been some ad hoc focus on risk related activities which has resulted in a fragmented approach to the identification, rating and management of risks.

In the absence of an established risk management framework, the compliance function is somewhat reactive and reliant on the existing corporate knowledge of its management team which can result in risks being identified and managed in a haphazard manner.

Despite the compliance review function being a high risk activity for the AEC and having a history of issues previously identified by the AEC’s internal auditors, there is no specific mention or reference to FAD’s compliance function in the AEC’s enterprise-wide risk assessment or AEC risk management plan. As a further consequence, risks can remain undetected or misinterpreted, and important risks can remain incorrectly perceived with compliance review staff resources being directed towards the wrong areas.

Further, the absence of a robust and defensible risk management framework can result in the compliance review management failing to report key risks to the AEC Executive<sup>4</sup> which reduces their ability to respond with a greater degree of confidence and assurance at the Joint Standing Committee on Electoral Matters (JSCEM) and Senate Estimate hearings.

The compliance function would benefit from the implementation of a robust and defensible risk management framework that encapsulates the framework components summarised in the following diagram:



#### *Mandate and commitment*

This relates to articulation and communication of the compliance function’s overarching objectives which will drive the risk management framework, including the AEC’s risk appetite in relation to the compliance function. The Portfolio Budget Statements 2012-13 make a high-level reference to ‘funding & disclosure services’, but do not provide any specific purpose regarding the scheme’s intent or objectives.

The absence of an overarching objective or understood purpose can impact the function’s ability to properly comprehend the associated risks and ensure the appropriate delivery of mandated roles and responsibilities.

#### *Governance and organisation*

This component relates to the compliance function’s risk management roles and responsibilities, levels of authority and arrangements for risk management.

Risk management is a key responsibility of the AEC Executive and Management. To achieve its objectives, the Executive and Management need to ensure that sound risk management processes have been established and are functioning. Ideally, the Executive should have an oversight role to determine that appropriate risk management processes are in place and that these processes are adequate and effective.

<sup>4</sup> Refer to section 2.1 relating to the Governance arrangements.

### *Communication and training*

This component incorporates arrangements for communicating risk management and providing the necessary training to the compliance review management and staff. These activities are necessary to:

- Build awareness of risk management initiatives and culture;
- Improve skills through formal training; and
- Increase knowledge through sharing best practices, evidence gathering and experiences.

### *Monitoring and review*

This component incorporates arrangements for monitoring the effectiveness of the compliance function risk management framework, reporting under governance arrangements, and reviewing and continuously improving the risk management framework.

### *Risk management process*

This key component of the compliance function risk management framework details the process for identifying, analysing, evaluating and treating risks along with arrangements for monitoring and review (including reporting) of risks and communication and consultation with the AEC Executive and relevant stakeholders.

There is currently no comprehensive risk management framework that identifies and manages the following types of risk categories (with examples) associated with the compliance function in a consistent manner:

- *Legislative compliance* – potential reputational damage due to ineffective or inadequate enforcement actions being taken in relation to Part XX of the Electoral Act;
- *Audit methodology weaknesses* - incomplete and inaccurate annual disclosure returns, and the risks associated with understatement or completeness of amounts disclosed due to an inadequate approach to conducting compliance reviews impacting the AEC's ability to fulfil its responsibilities in accordance with Part XX of the Electoral Act;
- *Human resources* – difficulty with attracting, retaining and recruiting appropriately skilled and proficient staff to work on the compliance function;
- *Information systems*– incorrect conclusions in compliance review reports due to staff making poorly informed decisions on critical aspects of the annual disclosure returns because of poor data management and lack of IT analysis skills;
- *Work, health and safety* – ineffective management of staff resourcing following prolonged periods of travel; and
- *Governance and reporting* – ineffective engagement by (and with) the AEC Executive diminishes the compliance function's alignment with organisational objectives resulting in the area becoming more remote and disconnected.<sup>5</sup>

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<sup>5</sup> As mentioned in the Governance section, a key input to the establishment of a robust and defensible risk management framework for the compliance review function is a sound understanding of the scheme's purpose, and objectives that stem from Part XX of the Electoral Act.

## Recommendations

R3 – A risk management framework needs to be established and implemented to support the compliance function to enable “a systemic, timely and structured approach to risk management that will contribute to efficiency and to consistent, comparable and reliable results”.<sup>6</sup> Critical features of the framework should include the following:

- Risk identification and analysis processes;
- Monitoring and review processes;
- Identification of supporting controls and measures to mitigate risks; and
- Assignment of roles and responsibilities to relevant managers.

R4 – An agreed set of strategic goals and objectives<sup>7</sup> for the compliance review function should be used to guide and design the risk management framework.

R5 – The risk assessment framework should include compliance investigations and provides management with guidance on circumstances warranting the exercise of powers under Section 316(3).

R6 – It is recommended that a risk assessment is used to inform decisions on whether an ‘investigation’ can be adequately conducted using the existing compliance team or may require the engagement of expert assistance.

R7 – The AEC needs to explore establishing arrangements with government agencies that are responsible for oversight of other regulatory schemes and/or similar surveillance activities relating to compliance with disclosure requirements (such as ASIC, Fair Work Australia, ACCC and ATO).<sup>8</sup> The relationship may not necessarily require formalisation; however, it could provide opportunities for sharing ideas and lessons learned regarding risk-based sampling techniques and other methods to improve transparency for the betterment of public interest.

Recommendations in relation to the establishment of a risk assessment process to inform future compliance review activity are included in Section 2.2.4 below.

### 2.2.4 Risk-based sampling processes to inform the compliance function

#### Observations

The coverage of political parties and associated entities on a cyclical basis through a routine schedule means the bulk of the sample selection process is not risk-based. This approach to compliance review coverage reduces the need to apply professional judgement and can result in staff time being unnecessarily allocated to compliance review activities that are less risky whilst providing insufficient attention to higher risk organisations.

There has been some documentation established by the compliance team that contributes towards a risk management framework. However, the existing tools are out dated,<sup>9</sup> unconnected and in certain instances the proposed controls are inadequate. The compliance review file provided in relation to the compliance review function’s risk management approach (titled *Compliance Audit – Compliance Visit Program Beginning 2011*), does not contain documentation to properly support the staff resource allocations or decisions regarding the selection of organisations for compliance review.

The compliance review sample selection process is reliant on the management team’s existing corporate knowledge, and an assumption that all returns will be covered in a three-year schedule. In effect, this involves allocating approximately two and a half years of compliance reviews which results in some parties being covered twice in that period if there was a Federal Election and a State Election. The availability of a ‘spare’ six months provides capacity to accommodate changing priorities, undertake ad hoc activities, or repeat coverage (e.g. Federal Secretariats being reviewed annually).

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<sup>6</sup> Refer to the ISO 31000 *Risk Management – principles and guidelines*.

<sup>7</sup> Refer above to Recommendation 1.

<sup>8</sup> Also, AUSTRAC is Australia’s anti-money laundering and counter-terrorism financing regulator and specialist financial intelligence unit which work collaboratively with a range of Australian industries (including government departments) and businesses.

<sup>9</sup> Last updated September 2009.

The ‘Compliance Review Coverage - triennial and annual planning’ documents the current schedule from 2011 onwards but does not explain the rationale or criteria applied when selecting the organisations for compliance review coverage. The current approach is reliant on the existing knowledge of compliance team management and is not established based on a robust and defensible framework or process.

At the July 2012 JSCEM hearing on the “AEC’s analysis of the Fair Work Australia report into the Health Services Union”, the AEC was criticised for the non-inclusion of trade unions in the compliance review program. Various opinions exist within the AEC regarding whether unions should be included in the program, and the extent to which they should be covered if they were deemed as in-scope.

An opposition member indicated an interest in the need to also apply the disclosure provisions and hence compliance review activities towards unions. On that basis the AEC needs to evaluate these claims and consider the consequences of potential options for the purpose of determining an agreed robust position that will assist in guiding the selection of a risk based sample.

A range of other Commonwealth government agencies are responsible for compliance related schemes and have implemented risk-based approaches to inform the sample selection process with the objective of actively improving disclosure and hence transparency. The AEC has not engaged with other agencies to share ideas and lessons learned on risk-based sampling techniques, but would benefit from establishing relationships with other counterparts.

### **Recommendations**

R8 - With limited resourcing, a comprehensive robust and reliable risk based sampling framework will enable compliance review management to make informed decisions regarding the optimal use of staff resources. This key information will enable selection of not only higher risk disclosure returns that warrant coverage, but also the most appropriate review methodology to be applied.<sup>10</sup> Key inputs to the sample selection process should include:

- Operations– operational maturity in an organisation drives the degree to which organisations have the ability to comply;
- Financial values and balances – both the volume and nature of a political party or associated entities’ financial transactions, as well as the financial position, may provide the AEC with direction of where to obtain the highest level of financial coverage;
- Past results - including issues identified during previous compliance reviews and the extent of ‘amendments’ in prior periods;
- Context or other intelligence gathering techniques - with links to information captured by the disclosure area including SuperFAD, media reports, state electoral bodies, perusal of other publicly available information<sup>11</sup> and analytical review techniques (such as annual return analysis);
- Other sources of assurance that are provided for individual entities, for example, oversight roles of other bodies or audited financial reports where they are prepared; and
- Ability to influence – without political representation in Parliament (currently, previously or likely into the future) the consequence of incomplete, inaccurate or late returns is diminished and should therefore form part of the risk weighting.

R9 – It is recommended that the risk-based sample selection process is complemented by an element of random inspection or spot audits to be obtained from the complete population. A compliance review element with less predictability will test the risk assessment framework’s validity, while raising awareness of registered political parties and their state branches and associated entities of the importance of accurate and complete disclosure returns.

The above recommendations are expanded in further detail at Appendix B.

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<sup>10</sup> Refer to further discussion in Section 2.3.3 regarding the need for the methodology to be appropriately tailored according to the risks and complexity of the organisation selected for coverage.

<sup>11</sup> Such as the Fair Work Australia website.

## **2.3 Audit Methodology**

### **Overview**

The objective of the compliance function is to increase overall transparency and inform the public about the financial dealings of political parties, candidates and others involved in the electoral process in accordance with Part XX of the Electoral Act.

The current approach involves checking certain financial records and documents requested by the AEC through section 316(2A) to determine the accuracy of the annual disclosure returns.

A range of source documents are checked during this process to determine the accuracy of amounts disclosed, including certain accounting records, bank statements, invoices, receipts, loan agreements and externally audited financial statements (where available). The books, records and financial records are often provided by organisations in inconsistent forms which directly impact the compliance review team's ability to apply a standard methodology. This variability is caused by a range of factors including regular changes of office holders, reliance on volunteers who may not have the requisite skills and experience, and limitations of the control frameworks and systems that are used to prepare annual disclosure returns.

The compliance team utilises the following forms of information technology during the course of conducting the reviews:

- IDEA audit software to extract client financial data;
- Excel spreadsheets to document testing and analyse results' and
- SuperFAD system to store a limited amount of information and records including correspondence.

There are three teams with the compliance review function that perform compliance reviews over the political parties. We performed an assessment of the compliance review methodology by gaining an understanding of the testing approach and by completing a walkthrough of systems used. This was validated by looking at a sample of compliance reviews conducted using the 2012 package across each of the three teams, in order to assess the appropriateness of the approach, scope and consistency of approaches applied in practice across the three teams (refer to detailed findings in section4).

### **2.3.1 Accountability**

#### **Observations**

The identification of organisations for review is routinely based on the Federal Election cycle. There are limited work papers or risk documents available to support the process undertaken by the compliance function to identify the organisations for review each year.

In addition, the compliance review team is not compelled to conduct regular reporting to the Chief Legal Officer regarding its key performance indicators, budget to actual results, annual reporting or the outcomes arising from significant issues identified during compliance reviews.

Between 2002 and 2007, the AEC's then internal audit service provider, WalterTurnbull, conducted a range of independent reviews of the compliance function. These reviews identified a number of key issues and recommendations relating to various aspects of the function, including its methodologies and approach. There have been no independent reviews or follow-up audits conducted during the past five years.

Discussions with the AEC's Strategic Capability Branch indicated the current internal audit service provider has not been requested to perform a review of the compliance function due to a perception that as a donor to political parties they could be considered as lacking independence or objectivity.

#### **Recommendations**

R10 - It is recommended that the Executive reviews, queries and formally approves the compliance review activities proposed for completion on an annual basis. The plan for compliance review activities should be derived based on a robust and comprehensive risk assessment process.

R11 –The compliance function should be accountable to the Executive through recognition in relevant elements of the AEC's governance structure including the strategic plan, enterprise risk assessment, annual reporting and organisational outputs.

R12 – An assurance framework for the compliance function should be established involving the independent review of its methodologies, approach and progress reporting on the implementation of past audit recommendations. This process should be conducted on a periodic basis with the objective of delivering continuous improvement, and be directed at the framework level (only) to reduce the conflict of interest perceptions. Any external people involved in this type of project should be required to review and submit a signed declaration of political neutrality.

### *2.3.2 Compliance investigations methodology*

#### **Observations**

There is limited methodology documentation available to support the compliance investigations ('special investigations') process which is performed in accordance with section 316(2A) and section 316(3). Three compliance team members have attained the Certificate IV in Government (Investigations). There are concerns around the capacity of team members to perform investigations, given the lack of appropriate skills and experience.

These limitations can impact the AEC's ability to conduct a complex or high profile compliance investigation. Only six compliance investigations have been conducted during the past two years. There is potential that the compliance function is under-utilising its power to further investigate potential contraventions that may come to its attention under Section 316(3). However, it is worth noting that not all investigations are performed under the power of Section 316(3) of the Electoral Act and published as such on the AEC's website.

#### **Recommendations**

R13 - The compliance function should develop a robust and defensible methodology to support its powers under Section 316(3) of the Electoral Act and assist with undertaking possible contraventions of the disclosure offences.

R14 – It is recommended that appropriate arrangements to enable access to specialist investigative services are established to provide the AEC with the capacity and necessary expertise on an as required basis for the conduct of compliance investigations in accordance with powers under Section 316(3). Specialist capacity could be sourced from existing Commonwealth government panels in the event of in-house capability being unavailable or unsuitable to the situation.

R15 - Compliance team member(s) should undertake any compliance investigation activities involving specialist expertise to facilitate knowledge transfer as a training opportunity for broader presentation on lessons learned to the compliance team and improve the methodology for future instances.

### *2.3.3 Planning*

#### **Overview**

Robust risk-based planning will provide a foundation for an effective compliance review and assurance that appropriate attention is to be focussed on the more important areas. Further, it will enable the managers to ascertain the nature, timing and extent of resources necessary to perform each compliance review selected for testing.

Planning on each compliance review should include the preparation of a detailed methodology, establishing a specific planning materiality, and guidelines in order for the compliance review teams to effectively perform the testing, analysis and reporting phases. Risk-based planning should result in the standard procedures being adapted to the situation on a case-by-case basis to reflect a range of key considerations that may be unique to each organisation.

#### **Observations**

The compliance team has documented testing guidelines, and has created testing templates within a 'package'. However, there is limited policy or procedures available on the risk-based planning process required to ensure an efficient and effective approach to compliance reviews. Further, there is no specific guidance or templates within the package to facilitate the planning process.

Planning activities suggested in the available guidance material are being inconsistently performed.<sup>12</sup> In addition, there are a number of planning activities required in the available guidance material which had not been addressed.

*Planning areas not addressed*

- There is no review of the risks associated with each organisation to determine the nature, timing and extent of testing that may be necessary.
- The 'Materiality - Application to Compliance Review findings' guidance document does not assess materiality during the planning phase of each compliance review to take into account the organisation's particular circumstances including its potential impacts on public interest. Rather, materiality is currently being assessed after each error or issues are identified.
- Minutes of the organisation's key meetings (if available), annual reports and management information are not requested or reviewed to provide further corroborative evidence to assist during the planning phase.

*Planning inconsistencies*

- There are variable approaches being applied when determining materiality and therefore assessing error levels.
- Inconsistent approaches to obtaining a preliminary understanding of the organisation and background issues (including a review of past compliance reports, media coverage) and a lack of documentation of this assessment.
- The forecast time for reviews does not reflect the actual time spent, which indicates that insufficient attention is being directed during planning towards understanding the organisation and its situation and assessing the risks of an incorrect disclosure return. It is envisaged that the recent introduction of the Kronos automated time-tracking software will improve the recording and monitoring of actual time incurred to inform or better inform future forecasts.

**Recommendations**

R16 – The 'planning' test guidance documentation should be developed and implemented which covers the following:

- Nature and extent of testing for each organisation proposed for compliance review coverage (this should be appropriately tailored on a case-by-case basis and largely dependent on outcomes of the risk assessment process to be performed on individual organisations);
- An assessment of materiality at the outset of a review;
- Understanding the organisation (including a review of minutes of meetings, annual reports, and high level analytical procedures);
- Project management and time allocation to each of the key tasks (including the budget preparation process and preliminary survey stage);
- Aspects of the organisation and its disclosure return that may present a higher risk of material misstatement;
- The impact of the assessed risk of material misstatement in the annual disclosure return including due consideration of public interest and the ability to influence;
- The selection of the compliance review team (including, the quality control reviewer) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement;
- Budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement, complexity and the volume of transactions;

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<sup>12</sup> The performance audit process involved reviewing a sample of compliance review work paper files.

## Observations

- Emphasis by compliance review team members on the need to maintain a questioning mindset and to exercise professional scepticism in gathering and evaluating evidence;
- Results of previous compliance reviews and any relevant media coverage;
- Significant current issues and other developments affecting the organisation, including changes in office holders, key management, information technology and business processes; and
- Other significant relevant developments, such as changes in the political environment affecting the organisation.

Certain aspects of these suggested improvements to the planning guidance material should, where appropriate, be incorporated into templates for inclusion in a current package of test guidelines.

### 2.3.4 *Completeness test objective*

#### **Observations**

Based on a review of the *Testing guidelines* compliance review document, there is limited testing on the risk of completeness (the risk that the information presented is missing transactions or disclosures) associated with the amounts reported on the annual disclosure returns. The completeness tests are being performed on a haphazard basis within the compliance review teams and there is inadequate evidence of appropriate documentation to support whether these procedures as being adequately performed.

Key areas include:

- Properly identifying and quantifying the total population of party units within an organisation under review;
- Performing trend analysis (analytical procedures) over receipts, payments, debts, and gifts-in-kind;
- Requesting and obtaining additional information from the organisation such as minutes, annual reports and documenting review;
- Reviewing bank reconciliations; and
- More in-depth accounting analysis (necessary for higher risk organisations).

Overall, the methodology is more focussed on the detailed checking of the accuracy of all information already provided by the political parties and associated entities in their annual disclosure returns. Efficiencies could be gained by testing a smaller sample of transactions, and using the additional time to perform more completeness testing across the above mentioned key areas.

#### **Recommendations**

R17 - The compliance function methodology should include an increased focus on the completeness<sup>13</sup> assertion involving additional testing to ensure that all transactions that should have been recorded have been recorded in the annual disclosure returns, thereby reducing the risk of annual disclosure returns being understated.

### 2.3.5 *Documentation*

#### **Observations**

The compliance function is required to maintain the working papers in hardcopy format. This is performed by teams completing work paper files for each organisation reviewed. The compliance function utilises a 'package' to formulate their testing work papers. However, there are elements of the documentation that have not been evidenced as completed and there are a number of documentation inconsistencies between the three teams.

*Documentation not addressed*

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<sup>13</sup> Completeness that all transactions that should have been recorded on the annual disclosure return should have been recorded.

## Observations

- There is no evidence of templates within the 'package' over areas such as 'preliminary assessment', 'materiality', completeness checks over data received (party units etc) and hence there has been limited documentation over these areas within the hardcopy files
- The current testing templates do not include the following elements i) test objective, ii) assertions covered, iii) materiality error level, iv) methodology (procedures) which would impact on the quality assurance reviewer's ability to comprehensively and efficiently evaluate the work performed.

### *Documentation inconsistencies*

- Level of testing detail
- Use of the prescribed templates
- Evidence of quality assurance review.

Further detail in respect to compliance and inconsistencies noted is included in section 4.

## **Recommendations**

R18 - Each work paper of the compliance review test 'package' needs to include the following elements:

- i) test objective;
- ii) assertions covered (namely completeness and accuracy);
- iii) materiality amount and tolerable error level; and
- iv) methodology (procedures based on the assessment of organisational risks), with a results section addressing what was performed.

This documentation will provide the necessary evidence to support the conclusions drawn and should be captured in an 'issues summary' containing testing results. The inclusion of a section regarding what was actually performed will enable the Team Leaders to perform a more effective quality assurance review of the work, rather than raising review queries. This should also provide efficiencies in review time.

R19- A database of better practice compliance review procedures and suggestions should be established to provide a central reference point as part of a continuous improvement program for the compliance review function and methodology.

## **2.3.6 Perceived Legislative barriers**

### **Observations**

Section 316(2A) of the Electoral Act requires organisations under review 'to produce, within the period and in the manner specified in the notice, the documents or other things referred to in the notice.' This provides the compliance function with the power to request additional information upon serving of notice under section 316(2A).

Previously, the compliance function has perceived there to be limitations associated with the Electoral Act that disallow certain documentation from being requested from the organisations that are issued with notices under section 316(2A). In effect, the interpretation and application of the Electoral Act have been restricted which has resulted in the compliance reviews having a reduced focus and not taking advantage of the full range of powers available.

### **Recommendations**

R20 - The compliance function should develop a comprehensive listing of information and documentation that can be readily tailored depending on the risk assessment and planning process prior to sending the request to organisations under a section 316(2A) to enable compliance reviews to be more thorough, efficient and effective.

R21 – The compliance function should establish a formal position on whether it will publish compliance review findings on the AEC website, and the extent of information it is willing to provide.

R22 – The compliance function would benefit from having a published policy on the follow up of actions arising from compliance review final reports, in order to ensure that consistent actions are being conducted and to raise awareness levels.

### ***2.3.7 SuperFAD and integration of FAD Disclosure and Compliance Review functions***

#### **Observations**

The SuperFAD system was developed at a cost of \$2.3m between 2009 and 2011 as a tool to assist with the submission of disclosure returns electronically to the AEC by the disclosing organisations.

The compliance function was consulted in relation to certain system requirements to assist the team with relevant functionality for conducting compliance reviews under section 316(2A).

Due to budget restraints, the compliance function's requirements were not included within the system's design, and hence there has been limited use of the SuperFAD system by the compliance function.

The current SuperFAD system has certain system features that can be utilised by the compliance team, including as a means to collect and capture intelligence regarding party information (media articles, client notes by the disclosure team). However, the compliance review team is currently making limited use of SuperFAD. An initiative being trialled is a new 'risk attribute' report to assist in the determination of which organisations may warrant further attention and review based on the outcomes of running certain parameters and attributes.

There is also evidence to suggest that SuperFAD can be utilised to create a workflow for each compliance review and for working papers to be stored within SuperFAD (in addition to paper files) as well as assisting with producing some of the standard correspondence.

It is understood that additional upgrades are being proposed for SuperFAD. Following implementation and testing of the next system upgrades, a post implementation review of outcomes should be conducted as part of the project delivery to determine:

- Whether the intended objectives of SuperFAD are being realised;
- How the actual costs and benefits compare against budget;
- The effectiveness and appropriateness of the implementation process;
- Causes of time and/or cost overruns, and quality and/or performance issues, if any;
- Productivity and performance improvements resulting from the implementation of SuperFAD;
- Whether SuperFAD users have been appropriately trained;
- Whether available features and procedures, as relevant, have been properly implemented; and
- Lessons learned from the implementation process to inform decision-making on future AEC projects.

#### **Recommendations**

R23 – SuperFAD should be consistently used by the compliance review function as a tool for collecting and capturing intelligence over party information. This should include the determination of organisational risk levels from the 'risk attribute' report which is currently being implemented and trialled. There is value in the further development of SuperFAD to accommodate broader business needs of the compliance review function to provide a central repository for appropriate information and intelligence gathering in relation to political parties and associated entities.

R24 – It is recommended that the compliance function should work with the FAD Disclosure area to determine the most cost efficient way to better integrate the compliance review function's system requirements into the SuperFAD system.

## ***2.4 Human Resource Management***

### ***2.4.1 Overview of Human Resource requirements***

#### **Overview**

Compliance reviews of the annual disclosure returns of federally registered political parties and their state branches and associated entities can be diverse and challenging for many reasons, including the:

## Observations

- Variability of financial management systems, reporting processes, and accounting policies adopted by the organisations;
- Lack of continuity amongst office holders;
- Inconsistent levels of financial expertise available within the organisations;
- Changing political landscape and interpretations of the Electoral Act; and
- Range and complexity of operations and structures that exist across many political parties and their state branches and associated entities.

Furthermore, the nature of the compliance function, its political profile, frequent criticism, and the difficulties involved with ensuring the completeness and accuracy of disclosure returns suggest that this is a high risk aspect of the AEC's responsibilities.

### Staffing

The compliance team has traditionally encountered challenges with attracting, training and retaining suitably experienced or qualified staff with the requisite audit and financial skills required to perform roles during the key phases of the compliance review process. The compliance function within FAD is comprised of seven staff including an EL2 Director, three EL1s, two APS 6s and one APS 5. The Director reports to the Chief Legal Officer (CLO) at SES level 1. However, the CLO has oversight of all major legal affairs of the AEC in a general counsel role which results in a restricted capacity for leadership and limited involvement with the compliance function.

The compliance team currently includes a blend of personnel with variable qualifications ranging from some tertiary accounting qualifications, to TAFE diplomas and other certifications. Some team members have previous audit experience while others have more general clerical backgrounds.

A number of the team members have worked in the compliance function for between five and ten years which has enabled them to build corporate knowledge of the annual disclosure return process. However, the scheme would benefit from supplementation of more contemporary audit and financial accounting skills, experience and qualifications in conjunction with some 'fresh thinking' and investigative skills.

The compliance function requires greater oversight and support from the senior executive levels that is commensurate with the risks associated with the AEC's responsibilities under Part XX of the Electoral Act. Hence the compliance function has a pressing need for higher level guidance and direct leadership at the Executive level.

### Training

Compliance team members have attended various forms of training in recent years which has generally been relevant to the roles. However, the decisions to invest time and resources into a program of training and development could be better informed by conducting a Training Needs Analysis. The main objective of this process is to identify the compliance function's optimal training requirements and the most cost effective means of addressing those requirements.

By undertaking a Training Needs Analysis management will have a more accurate perspective of training and skills requirements as well as identifying more efficient and effective approaches to designing an optimal staff development program.

### Workforce planning

To date, there has *not* been any workforce planning review of the compliance function. This type of analysis would provide the AEC Executive with a framework to make staff and resource allocation decisions based on the compliance function's overarching objectives, mission, strategic plan, risk assessment, existing resource base, and the preferred workforce competencies.

The resultant information would provide a reliable indication of whether the compliance function has the optimal staff resources and levels including the appropriate skills, qualifications and experience required to fulfil its responsibilities under Part XX of the Electoral Act.

Access to appropriate staffing would involve considering a range of potential approaches to the business model, including:

- Employment of APS staff with the requisite skills and experience;

- Contracting with subject matter specialists;
- Succession planning;
- Partnerships;<sup>14</sup> and
- Revamping the risk management framework<sup>15</sup> and compliance review methodology<sup>16</sup> to align with the proficiencies required.

The compliance function is reliant upon the existing team's corporate knowledge gained over a number of years. However, the risk of some staff leaving the section in the next few years resulting in a loss of that experience has also been recognised.

To mitigate the potential consequences, a strategic workforce plan would take into account the projected loss of knowledge through staffing exits and the projected knowledge requirements for sustaining and enhancement of the compliance review function. Knowledge requirements may include better use of technology (including internal systems), strategies to acquire new skills, professional development opportunities, documentation of key workforce intelligence or new business demands.

### *2.4.2 Recommendations – Human Resource Management*

R25 - It is recommended that a comprehensive workforce planning<sup>17</sup> process of the compliance function is conducted, and appropriately supported and monitored by a committed AEC Executive. Outcomes from the workforce planning process must:

- Be appropriately documented in a structured project plan that identifies and captures all key changes to be managed, and their interdependencies; and
- Include the identification of what is to be achieved, actions required, the responsible officers and target dates.

R26 – A strategy should be developed and implemented to attract, recruit, train and retain the optimal staffing mix with suitable qualifications, experience, skills. This strategy should be based on results of the workforce planning process and risk assessment.

R27 – It is recommended that the compliance function establishes arrangements to enable access to appropriate subject matter specialists and technical expertise to provide assistance across certain aspects of the scheme including the provision of in-house training. Assignments that utilise external specialists should involve working directly with a core compliance team member(s) to facilitate knowledge transfer as an additional training opportunity to build on lessons learned and improve the existing methodology.

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<sup>14</sup> Arrangements should be explored with other government agencies (such as ASIC and ATO) that are responsible for regulatory schemes that involve ensuring compliance with disclosure requirements.

<sup>15</sup> Refer to section 2.2 of this report.

<sup>16</sup> Refer to section 2.3 of this report.

<sup>17</sup> The workforce planning process should be based on outcomes from the risk assessment (refer to section 2.2 of this report).

# 3 Compliance function – methodology and work papers review

## 3.1 Our approach

During the performance audit fieldwork, we considered the methodology and approach for conducting compliance reviews under section 316(2A) of the Electoral Act. This involved evaluating the documented methodology, conducting discussions with the compliance function’s Director and EL1s, and obtaining a walkthrough of the key systems used during compliance reviews (IDEA and SuperFAD in conjunction with Microsoft Excel).

Key observations and issues identified during this process are discussed above in section 2.

After obtaining an initial understanding, we assessed the appropriateness of the scope and focus of compliance reviews performed, by looking at a sample of the work paper files for reviews completed during the 2012 calendar year.

The completed compliance reviews were selected as a sample across the three compliance teams, spanning different political parties and party organisations with and without party units, and associated organisations.

Our process focussed on whether the reviews performed:

- a) Addressed the intentions and purpose of Part XX of the Electoral Act, and any relevant principles provided in certain Auditing standards;
- b) Are consistently and effectively completed across the sample of compliance reviews; and
- c) Include an appropriate level of testing with sufficient evidence to support the conclusions drawn and quality assurance on the outputs.

## 3.2 Detailed findings – methodology and work papers

There were a number of issues identified during our assessment, which are summarised by key topic in the following tables.

### (i). Compliance with procedures

Reference	Topic	Issue
4.2.1	Evidence of review	Inconsistent approaches to documenting evidence of quality assurance review and dating of work papers. Further, there is a requirement for each file to have an independent review process performed (i.e. different preparer and reviewer).
4.2.2	Party Unit list completeness review process	As per testing guidelines - <i>‘For disclosure returns that cover a federal election year, a check must be made of the party unit listing to determine whether finances have been reported for every campaign committees in each electorate the party stood a House of Representatives candidate and Senate group. An immediate explanation must be obtained from the party agent for any apparent omission. In a return covering a federal election, the list of party units provided by the party agent must be checked to ascertain that there is a full list of campaign committees for every electorate contested in that State/Territory. Any campaign committee missing, or that has lodged a ‘nil’ return, must be queried with the party agent and a formal explanation obtained.’</i> There was no documented evidence of this process having been conducted amongst the files with party units involved.

4.2.3	Commencement approval	Three out of the nine files (i.e. 33%) assessed by PwC did not have the required Director’s endorsement for commencement available on file.
4.2.4	Party units testing	Within the sample selected it appeared that testing over party units was only performed in relation to 'total receipts' and 'total payments'. Other elements such as ‘gifts-in-kind’, ‘total debts’ and individual donations testing were not performed (based on an understanding that party units testing should be conducted in accordance with the established methodology).
4.2.5	Approval of Management report	Six out of nine files reviewed did not include approval of the report by the compliance function’s Director.

**(ii). Consistent application of methodology**

The following inconsistency issues were identified across the work paper files assessed:

- Level of testing detail documented;
- Use of internal templates; and
- Evidence of review.

These issues are detailed below:

<b>Reference</b>	<b>Topic</b>	<b>Issue</b>
4.2.6	Level of detailed testing	There were inconsistencies across the work paper files in relation to the level and depth of documentation of detailed testing undertaken. This implies that not all the required compliance review testing had been performed.
4.2.7	Party unit sampling selection documentation	There is inconsistent documentation to support the process of selecting party units, which purports to be based on five categories within methodology (namely: materiality, anomalies, nil lodged, other and professional judgement).
4.2.8	Supervisor’s review	Six out of nine files did not include a supervisor's performance review for the preparer. In addition, there were inconsistent approaches across the work paper files in terms of the documentation of review / follow-up points.
4.2.9	Final approved report	There are varying final report templates being used across compliance reviews. More specifically, this relates to recognition of whether the objective of compliance review is in accordance with the Electoral Act.
4.2.10	Follow-up of report implications performed	Inconsistent approaches were identified across the work paper files in relation to documenting the follow-up of findings and ensuring amendments to returns have been addressed appropriately.
4.2.11	Issues summary	Inconsistent levels and standards of documentation of the ‘Issues Summary’ across the work paper files assessed.
4.2.12	Notification of Party review (including notification of review/call/letter)	Inconsistent documentation of important file notes including the minuting of phone calls and conversations in work paper files.

**(ii). Better practice suggestions**

The following observations represent some 'better practice' suggestions that warrant compliance review management's consideration (in addition to the above mentioned issues identified).

<b>Reference</b>	<b>Topic</b>	<b>Better practice</b>
4.2.13	Quality Assurance review	<p>Only one out of nine compliance review work paper files contained evidence of a quality assurance review being performed (this process is in addition to the standard review process).</p> <p>The process would benefit by implementing a rolling quality assurance program involving the Director performing a number of random QA reviews each year to ensure consistent application of the established methodology across all teams.</p>
4.2.14	Letter of representation	<p>The 'Party Unit Compliance Review Questionnaire' is distributed with the notification to produce documents which includes a number of questions that require an organisation to respond and provide sign-off. This questionnaire should be used more broadly for all compliance reviews to obtain additional assurance as a further evidence gathering process.</p>
4.2.15	Referencing/file tidiness	<p>All hard copy work paper files maintained should be appropriately referenced and folioed (including cross-referencing of the interrelated supporting work papers).</p>
4.2.16	Site visits guidelines/ Debrief	<p>The compliance function would benefit from establishing guidelines on the circumstances that may warrant onsite fieldwork. Ideally, this would be based on outcomes from the risk assessment process and be supported by guidance for staff to consider prior to performing site visits.</p>
Other	Best practice repository	<p>The issues identified from the assessment of compliance review work paper files indicated there are inconsistencies between compliance teams regarding the application of methodology, documentation and level of detailed review performed. On that basis, the compliance function would benefit from a 'best practice' database for the teams to regularly access and use as guidance (highlighted as recommendation above). In addition, it would be worthwhile rotating the team members (APS6) across the EL1s to share ideas, improve methodologies and encourage consistency when performing compliance reviews.</p>



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# Appendix A Consultation

<b>Name</b>	<b>Position / title</b>
Mr Ron McLeod AM	Principal Reviewer
Ms Christine Wickremasinghe	Assistant Director
Mr Tom Rogers	Deputy Electoral Commissioner
Mr Paul Pirani	Chief Legal Officer
Mr Neal Mason	Assistant Commissioner People Services Branch
Ms Kathy Mitchell	Assistant Commissioner Education and Communications Branch
Mr Brad Edgman	Director – Compliance Review
Ms Sue Sayer	Director – Disclosure Section
Mr Alan Page	Assistant Director – Compliance Review
Ms Anna Jurkiewicz	Assistant Director – Compliance Review
Mr Ralph Fayed	Assistant Director – Compliance Review
Ms Dawn Berenger	Assistant Director – PMO, Strategic Capability Branch

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***Appendix B Risk  
assessment methodology  
for compliance review  
activity***

# **1 Introduction**

## **1.1 Scope of the proposed sampling framework**

The scope of this engagement was to work with AEC staff and Mr Ron McLeod AM to develop a robust and defensible framework to identify the political parties and associated entities that should be subject to compliance activities each year.

The key deliverable is a defensible risk assessment framework for the identification of entities to be subject to compliance review activity. This framework will drive detailed calculations to establish a risk score for each political party and associated entity which will assist the AEC to identify and prioritise those warranting compliance activities, as well as the likely frequency and degree of scrutiny.

It is intended that the risk-based sampling framework proposed in the following sections will continue to evolve and be progressively implemented over time which will involve further adaptation based on lessons learned and results obtained. The risk assessment framework and the results of compliance activity and other intelligence sources will need to be incorporated into future refinements to the framework. The anticipated benefits of taking a risk-based approach are:

- To better identify areas of greatest concern, targeting likeliness and severity of non-compliance with statutory requirements of the Electoral Act;
- Prioritisation of compliance review activity; and
- More effective allocation of the AEC's resources in terms of both scrutiny of political parties and associated entities and required experience of staff.

The Director of the Compliance Review function was consulted during this review and input was provided on the types of risk assessment factors to be considered. A review of the UK electoral funding compliance and disclosure process was also completed to identify and understand similar challenges to inform this framework.

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## 2 A risk-based approach to the AEC's compliance activity

### 2.1 Objectives of the financial disclosure scheme

The stated objective of the AEC's compliance review activities, with regards to the annual disclosure returns of federally registered political parties, their state branches and associated entities, is to:

*"...assess whether the return as lodged is a complete and accurate record as required by the disclosure provisions contained in Part XX of the Commonwealth Electoral Act 1918 (the Act)".<sup>18</sup>*

This objective is therefore effectively the combination of three sub-objectives:

1. **Completeness of the return:** That the return captures all the types of information required (such as a full list of donors).
2. **Accuracy of the return:** In addition to capturing all the types of information required, that each return is accurate (such as the correct amount donated by each donor).
3. **Timeliness of the return:** Although not explicitly stated in the overarching objective of the compliance review activities, given the legislative requirements regarding the timeframe within which returns must be lodged, it is worth highlighting separately.

The AEC plays a key role in ensuring the broader integrity of the electoral process. The complete, accurate and timely lodgement of returns (once reported) allows the Australian voting public to be informed of the nature and extent to which funding from private sources exists and is being directed towards the electoral process. As such, it is important that the AEC's compliance activities are viewed by the public as more than a simple "housekeeping exercise". Failure to play this role runs the additional risk of diminished public confidence in the electoral process and, in turn, the public's confidence in their institutions and elected officials.

### 2.2 Limitations of the AEC's current approach

The current approach to compliance reviews is that each political party is to be reviewed once every three years. These reviews involve checking the disclosure returns against party and associated entity financial records (e.g. ledgers, bank accounts and financial statements), as well as returns submitted by associated entities, private organisations or individuals and returns of the political parties.

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<sup>18</sup> Obtained from [http://www.aec.gov.au/Parties\\_and\\_Representatives/compliance/compliance-reviews.htm](http://www.aec.gov.au/Parties_and_Representatives/compliance/compliance-reviews.htm) 9 November 2012

As stated on the AEC's website:

*Compliance reviews are undertaken over a three year cycle in the course of which every political party can expect to have at least one of its disclosure returns reviewed. It is the [Australian Electoral Commission]'s usual practice to also review the returns for the same year of the associated entities of a party being reviewed.*<sup>19</sup>

Given the limited resources that the AEC has to undertake compliance review activities, a cyclical approach attempting to cover all organisations would not represent optimal allocation of the compliance team's resources. While there is some implicit risk assessment undertaken by management (based on experience and judgement) in the current cyclical program, there is no formal and defensible risk-based approach to identify which political party(ies) and their associated entities should be the subject of compliance reviews.

The underlying premise of the current approach is that fairness is being achieved via all returns being covered over a three-year cycle. A key feature that supports this approach is a reduced perception that certain political parties or associated entities may not have been subject to compliance review activity during the cycle.

### **2.3 Risk-based compliance approach**

A risk-based sampling methodology should be designed to identify the key risks that might restrict the achievement of compliance review objective(s) and establish the factors which indicate the likelihood of these risks materialising. Furthermore, given the limited resources, a comprehensive, robust and reliable risk-based sampling framework will enable the compliance review team to make informed decisions regarding the optimal use of staff resources (in the absence of being able to perform detailed checking of all returns every year).

Ideally, a risk-based approach should be comprised of three main elements:

**Risk scoring framework** – The risk scoring framework is the core piece of the risk-based approach. The risk framework identifies the relevant data to be used in risk analysis, and provides a clear logical rationale explaining the reason each piece is critical to the overall picture. Further, depending on the nature of the risk assessment process, it may provide guidance with respect to the calculation of an overall risk score.

**Organisation profiles** – A profile would serve as a useful vehicle to gather, consolidate, analyse and communicate a compelling narrative concerning the political landscape and the key players within. A formal profiling process not only allows for information to be updated, but facilitates the review and reassessment of the initial risk ratings assigned.

**Selection process** - An important element of a risk-based compliance approach is an element of randomness or degree of uncertainty. This is important because it introduces an unknown element and flexibility while maintaining the impartiality of the AEC.

In practice this collective approach means that those federally registered political parties (including their state branches) and associated entities with a higher likelihood of risks would be identified and have a greater *chance* of being selected in any given period than those with a lower likelihood. It would not, however result in those with a lower risk rating would be completely excluded from the possibility of compliance review.

### **2.4 Risk**

Within the above context, the two primary risks to the achievement of the objectives of the compliance review activities of the AEC are:

- The risk of an incomplete or inaccurate return; and

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<sup>19</sup> Per the AEC website: [http://www.aec.gov.au/Parties\\_and\\_Representatives/compliance/compliance-reviews.htm](http://www.aec.gov.au/Parties_and_Representatives/compliance/compliance-reviews.htm) obtained 21 September 2012.

- The risk of a return not being submitted or submitted after the required deadline (late return).

Within the context of these risks, underlying factors also need to be considered in relation to estimating the likelihood of these risks materialising and the potential consequences if they do.

The critical task in developing a risk-based compliance framework is identifying risk factors (and associated measures) that would impede achievement of the AEC's objectives. While these risks appear straight forward, they could be caused by the result of any number of underlying factors, deliberate or accidental.

It is also important to highlight risks not intended to be considered in the context of this risk-based compliance review framework to remove any additional expectations. Along those lines, the scope of this risk-based framework is *not* designed to:

- Detect broader corruption / influence peddling (outside the context of election disclosure);
- Determine appropriateness of private funding and its sources; and
- Determine the appropriateness of donations or other financial arrangements (i.e. between political parties and associated entities).

## **2.5 Proposed risk indicators**

On balance we believe there are six main risk indicators that collectively provide insights into the likelihood and consequence of the risks outlined previously materialising, these are:

- Operations – operational maturity in an organisation drives the degree to which organisations have the knowledge and ability to comply. Organisations with lower levels of operational maturity pose considerably higher risk of error and omission occurring, particularly in cases where large sums of money or large number of transactions are involved.
- Financial values and balances – both the volume and nature of a political party or associated entities' financial transactions, as well as the financial position, may provide the AEC with an indication of trends around where to obtain the optimal levels of coverage. Volumes of transactions or trend analysis may also provide insights to direct compliance activity to entities demonstrating unusual trends.
- Compliance history – would include the results of any relevant previous AEC compliance reviews as well as the historical ability of the body to lodge complete and accurate returns on a timely basis (factoring in any previous amendments required).
- Context – the information disclosed to the AEC may not, in isolation, provide a sufficient indication of the degree of scrutiny required. Taking a broader view, other government agencies, the public and the media reports can all play a role in identifying corroborative information and contextual factors that may warrant greater scrutiny by the AEC.
- Third party sources of assurance – the level and nature of third party scrutiny on the organisation should also be considered (and potentially provide AEC with some assurance). For example, the existence of audited financial statements and regulatory oversight may mitigate certain risk factors, depending on the nature and scope of the assurance work conducted.

Collectively, the five factors above can be rated to contribute towards determining an overall risk rating in relation to the likelihood of compliance review risks materialising.

A comprehensive risk-based sampling approach also needs to assess the consequences. A critical factor required to measure this is:

- Ability to influence – without political representation in Parliament (currently, previously or likely into the future) the consequence(s) of incomplete, inaccurate or

late returns is diminished and should therefore be a consideration when undertaking the risk scoring process.

It is worth noting that each of these six indicators (which are further expanded Table 1 on the following page) would need to be weighted appropriately to reflect the varying levels of importance associated with each risk indicator to determine an overall risk score. Equally, the individual risk rating for each indicator would likely be based on a non-linear (exponential) weighting, for example, weightings of 2, 4, 8 and 16.

The use of risk indicators and a weighting process to determine which political parties and associated entities may warrant coverage should be viewed as an initial process towards identifying and deciding where to direct compliance review resources. Another key step needs to include workshopping the results of the weighting and 'scoring' process to further refine the listing for coverage prior to seeking formal approval from the AEC Executive.

**Table 1 Risk assessment logic model**

<b>Risk indicator</b>	<b>Potential measures</b>	<b>Rationale</b>	<b>Information currently available</b>	<b>Readily available</b>	<b>Required going forward</b>
Operations	<ul style="list-style-type: none"> <li>Automated / manual systems</li> </ul>	<ul style="list-style-type: none"> <li>Automated systems would indicate higher sophistication</li> <li>Expect higher degree of accuracy and compliance with timelines</li> </ul>			✓
	<ul style="list-style-type: none"> <li>Business sophistication / understanding of legislative requirements</li> </ul>	<ul style="list-style-type: none"> <li>Provides a qualitative indication of an organisation’s understanding of what is required</li> <li>Sets an expectation for the AEC with respect to operational relationship and future engagement strategy</li> </ul>			✓
	<ul style="list-style-type: none"> <li>Dedicated accounting staff</li> </ul>	<ul style="list-style-type: none"> <li>Indicates ability to produce high quality disclosure returns</li> <li>Indicates ability to process transactions accurately and in a timely manner</li> </ul>			✓
	<ul style="list-style-type: none"> <li>Turnover of key staff</li> </ul>	<ul style="list-style-type: none"> <li>Indicates levels of experience and ability available to process transactions accurately and in a timely manner</li> </ul>			✓
Financial values and balances	<ul style="list-style-type: none"> <li>Total reported income</li> </ul>	<ul style="list-style-type: none"> <li>Highlights the size and complexity of the political party or associated entity</li> <li></li> </ul>	✓		
	<ul style="list-style-type: none"> <li>Volume of transactions</li> </ul>	<ul style="list-style-type: none"> <li>Highlights the size and complexity of the political party or associated entity</li> <li></li> </ul>		✓	

Risk indicator	Potential measures	Rationale	Information currently available	Readily available	Required going forward
	<ul style="list-style-type: none"> <li>Debt / receipt ratios</li> </ul>	<ul style="list-style-type: none"> <li>Highlights the financial health of the organisation or entity in question, in particular the ability to operate in an efficient and effective manner</li> <li>May provide an indication of underlying motivation to fully disclose all relevant transactions (e.g. financial difficulty may provide an incentive to hide details of transactions)</li> </ul>	✓		
	<ul style="list-style-type: none"> <li>Material inaccuracies</li> </ul>	<ul style="list-style-type: none"> <li>While a minor amount of variance may be acceptable (i.e. variance due to rounding), larger variances may point towards other errors or omissions</li> </ul>	✓		
	<ul style="list-style-type: none"> <li>3 year rolling average of disclosures</li> </ul>	<ul style="list-style-type: none"> <li>Trend over time and identify variances that may warrant greater scrutiny or a change in risk rating</li> </ul>	✓		
Compliance history	<ul style="list-style-type: none"> <li>Frequency of missing / late returns</li> </ul>	<ul style="list-style-type: none"> <li>Indication of potential future missing / lateness of disclosure returns</li> </ul>	✓		
	<ul style="list-style-type: none"> <li>Number of inaccurate / incomplete disclosure returns (self assessed and not AEC identified)</li> </ul>	<ul style="list-style-type: none"> <li>Indication of potential future accuracy / completeness of disclosure returns</li> </ul>	✓		
	<ul style="list-style-type: none"> <li>Known issues with previous compliance reviews (AEC identified issues)</li> </ul>	<ul style="list-style-type: none"> <li>Other issues arising during compliance reviews that may indicate whether disclosure returns will be accurate, timely and complete (e.g. errors, excessive delay providing documents, tardy or no response to follow-up queries etc.)</li> </ul>	✓		
Context	<ul style="list-style-type: none"> <li>Known breaches of legal or professional ethical requirements</li> </ul>	<ul style="list-style-type: none"> <li>Media, government agencies or the public may report breaches of legal or professional requirements that would cause concern as to whether return disclosures are accurate or complete</li> </ul>		✓	

Risk indicator	Potential measures	Rationale	Information currently available	Readily available	Required going forward
	<ul style="list-style-type: none"> <li>Known financial or operational difficulties</li> </ul>	<ul style="list-style-type: none"> <li>Media, government agencies or the public may report financial or operational difficulties that would cause concern as to whether return disclosures are accurate or complete</li> </ul>		✓	
Third Party Sources of Assurance	<ul style="list-style-type: none"> <li>Additional regulatory scrutiny</li> </ul>	<ul style="list-style-type: none"> <li>Political parties, candidates, associated entities, etc. may be subject to other forms of assurance under separate statutory or regulatory schemes</li> </ul>		✓	
	<ul style="list-style-type: none"> <li>Other sources of assurance</li> </ul>	<ul style="list-style-type: none"> <li>Political parties, candidates, associated entities, etc. may be subject to other financial or controls assurance under separate statutory or regulatory schemes</li> </ul>		✓	
Ability to Influence	<ul style="list-style-type: none"> <li>Past, sitting or likely future member of Parliament</li> </ul>	<ul style="list-style-type: none"> <li>Members likely (past, sitting or likely future) have greater power and influence than newly elected members</li> <li>There may be greater incentive for others to attempt to influence the party or candidates through donations, or otherwise submitting late or amended returns</li> </ul>	✓		
	<ul style="list-style-type: none"> <li>Advocacy or other influential individual or group</li> </ul>	<ul style="list-style-type: none"> <li>Advocacy or other influential individuals or groups may have specific interest in supporting a particular candidate or party</li> <li>There may be a greater incentive or in omitting or misrepresenting contributions, or otherwise submitting late or amended returns</li> </ul>	✓		

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# ***Appendix C Implementation of past internal audit recommendations***

Assessment of progress achieved against a sample of past internal audit recommendations

A risk-based approach to the AEC's compliance activity

Audit name	Prior recommendation	Current status
<b>2006 Risk Analysis Model *</b>	The FAD Section should ensure that when scores are allocated to political parties/entities as part of a risk analysis process during the planning phase, explanations for derivation of scores are documented as evidence of the assumptions and rationale applied.	 Refer to section 2.2.4 of report.
<b>2007 Risk Analysis Model*</b>	The FAD Section should ensure all future meetings, which involve key decisions relating to the compliance review process, are formally documented and maintained on file to ensure the probity and transparency of the process.	 Refer to section 2.2.4 of report.
<b>Compliance Investigation Review Progress</b>	The FAD Section should ensure that all Compliance Investigations are conducted, finalised and reported to the political party/entity within a reasonable timeframe (to be determined).	 Refer to section 3.8.2 of report.
<b>Compliance Investigation Package</b>	The FAD Section should ensure that the Compliance Investigation Package is finalised and endorsed prior commencing the 2008 Compliance Review Program.	 Refer to section 3.8.2 of report.
<b>Referencing</b>	All workpapers should be appropriately referenced and cross-referenced to supporting documentation. The importance of correct referencing should be promulgated to all AEC FAD Officers and could be covered at the next FAD training session, which is held.	 Refer to section 4.2 of report
<b>Reconciliation of the Trial Balance to the Audited Financial Statements</b>	FAD should therefore introduce a testing procedure as part of the compliance investigation package that ensures that the year-end trial balance obtained agrees to the audited financial statements.	 Refer to section 3.8.4 of report
<b>File Review</b>	Despite the vacancies, the FAD Section should ensure that all files are reviewed for quality assurance purposes prior to the issue of the Compliance Report. This will provide the AEC with greater assurance that all necessary audit work has been conducted and all outstanding issues have been followed up.	 Refer to section 4.2 of report

\* The application of risk analysis techniques by the AEC was in its infancy at the time of these reviews.

A risk-based approach to the AEC's compliance activity

<p><b>Entrance Interview Questions and Summary of Findings</b></p>	<p>The FAD Section should ensure Entrance Interview Questions and the Summary of Findings work papers are fully completed including referencing to the audit evidence obtained.</p> <p>Internal Audit has also previously identified this issue in the January 2006 FAD – File Quality Assurance Reviews report.</p>	<p> Refer to section 4.2 &amp; 3.8.5 of report</p>
<p><b>Review of Minutes</b></p>	<p>The FAD section should ensure dates of all relevant minutes of meeting reviewed are recorded. The total number of meetings held during the period should also be documented and reconciled to the total number of meetings reviewed to ensure complete coverage for the review period.</p> <p>Internal Audit has also previously identified this issue in the January 2006 FAD – File Quality Assurance Reviews report.</p>	<p> Refer to section 3.8.3 of report</p>
<p><b>Financial Statement Variance Analysis</b></p>	<p>The FAD Section should ensure sufficient Financial Statement Variance Analysis is performed for each party/entity reviewed. A broad statement indicating movements are in accordance with the business cycle does not constitute a sufficient variance analysis. Nor does this indicate that the FAD Officer conducting the Compliance Review has a reasonable understanding of the key reasons for the movements.</p> <p>Internal Audit has also previously identified this issue in the January 2006 FAD – File Quality Assurance Reviews report.</p>	<p> Refer to section 3.8.4 of report</p>
<p><b>Missing Work Papers</b></p>	<p>The FAD Section should ensure all workpapers are completed in full, and where the procedure is not required or performed, an explanation on how this conclusion was reached should be documented.</p> <p>Internal Audit has also previously identified this issue in the January 2006 FAD – File Quality Assurance Reviews report.</p>	<p> Refer to section 4.2 of report</p>
<p><b>Bank Reconciliations</b></p>	<p>The FAD Section should ensure cash at bank testing is performed to ensure cash is fairly stated. Testing performed should consist of reviewing outstanding deposits and outstanding payments in the bank reconciliations greater than \$10,000 and then tracing them to the annual returns. This should include the review period ending date and could also include a sample of months during the period of coverage.</p> <p>Internal Audit has also previously identified this issue in the January 2006 FAD – File Quality Assurance Reviews report.</p>	<p> Refer to section 3.8.4 of report</p>
<p><b>Limited Use of Electronic Data</b></p>	<p>If sufficient electronic data and other information are made available by “low risk” parties/entities, the compliance reviews could to an extent, be conducted in-house at the AEC’s National Office thereby improving efficiency of the review program (i.e. a reduction resources required). Refer to section 2.3 of this report for information on the current development of an online lodgement system.</p> <p>Internal Audit has also previously identified this issue in the January 2006 FAD – File Quality Assurance Reviews report</p>	<p> All reviews are performed in house/ but no assessment of risk performed,</p>



# Appendix D Performance audit – PwC terms of reference

## AEC's disclosure compliance function under Part XX of the Commonwealth Electoral Act 1918: Review and performance audit

### Terms of Reference:

One of the Australian Electoral Commission's (AEC) seven core business functions under the *Commonwealth Electoral Act 1918* (Electoral Act) is to administer election funding, financial disclosure and party registration requirements.

The AEC engaged Mr Ron McLeod AM to:

- Ascertain the nature and type of work required to fulfil the AEC's statutory responsibilities in relation to monitoring and enforcing compliance by political parties, associated entities, donors and other third parties with the disclosure provisions in Part XX of the Electoral Act; and
- Taking into account the nature of the statutory responsibilities and the nature of the work required to fulfil these, determine the most effective and efficient way in which the AEC can monitor and enforce disclosure compliance under the Electoral Act, including:
  - A consideration of the extent to which the AEC needs to further develop educative and informative measures to encourage voluntary compliance as opposed to *ex-post-facto* enforcement; and
  - A consideration of whether the AEC's current organisational structure most appropriately accommodates the functions of administering election funding, financial disclosure and party registration.

Mr McLeod's review of the AEC's disclosure compliance function was complemented by a performance audit by PricewaterhouseCoopers (PwC) which:

- In light of the scope and nature of the statutory responsibility and the type of work deemed necessary to fulfil it, involved an assessment of the efficiency and effectiveness of the AEC's conduct of compliance reviews, including:
  - A review and evaluation of internal policies and guidance material on Part XX of the Electoral Act regarding the compliance review function, such as:
    - Processes and procedures, including risk assessment frameworks which are used to guide decisions regarding work programs;
    - Audit methodologies, including the depth of testing performed; and
    - Past internal audit reports and recommendations.
  - An examination of the appropriateness of the scope and focus of compliance reviews; and
  - An examination of whether the current workforce model in relation to disclosure compliance is appropriate to achieve efficient and effective compliance review coverage, and how it can be improved.

The performance audit has been used to inform the broader review being conducted by Mr McLeod.