
**REPORT OF THE
INDEPENDENT PERFORMANCE AUDIT OF THE
OPERATIONS OF THE ACT AUDITOR-GENERAL
AND THE ACT AUDIT OFFICE**

**Bob Sendt & Associates
3 May 2010**

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The Speaker
Legislative Assembly for the ACT
GPO Box 1020
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Dear Mr Speaker

**Independent Performance Audit of the
Operations of the ACT Auditor-General and the ACT Audit Office**

On 19 February 2010 and pursuant to section 29 of the *Auditor-General Act 1996*, the Chair of the Legislative Assembly's Public Accounts Committee requested me to perform the above audit.

In accordance with section 31 of the Act, please find enclosed my Report for presentation to the Assembly.

Yours sincerely,

Bob Sendt

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Note: To avoid confusion with audits undertaken by the ACT Audit Office, I have used the term ‘Review’ in this Report to refer to this performance audit of the Office.

1. EXECUTIVE SUMMARY

(SEE ALSO THE COMPLETE LIST OF FINDINGS AND RECOMMENDATIONS IN APPENDIX 4)

Based on my Review¹, I believe that the ACT Audit Office is providing an important service in an efficient and effective manner, and the Legislative Assembly and people of the Australian Capital Territory are achieving good value from the Office's use of the taxpayer's dollar. It achieves this notwithstanding the relatively small size of the Office, the complexity of its role and the demands upon it.

In my view the Office has enthusiastically embraced the challenge of the tougher new auditing and quality control standards of recent years. It has invested considerable resources in ensuring it has the quality processes in place to guide its future operations.

The views of a sample of key stakeholders I interviewed - Members of the Legislative Assembly and senior officers from a range of government entities - were largely complementary of the professionalism of the Auditor-General and her team. A number of audit clients particularly noted the approachability of the Auditor-General and her senior staff and their preparedness to listen to differing views. These client views accord with results from the more formal, regular feedback surveys that the Office conducts.

Certainly this positive attitude was more pronounced in respect of financial audit clients. Performance audits, by their nature, are more likely to be controversial than financial audits and their findings are likely to involve a greater degree of professional judgement. Some audit clients particularly commented on the level of staff turnover in this area and the difficulties this created for them and the Office. I was also aware of the concerns held by some Members of the Legislative Assembly as to the appropriateness of some recent performance audits undertaken.

Staff appear to be very highly engaged with the Office, and feel that their work is satisfying and worthwhile. The Office has set out a vision for the future and a set of values that are both appropriate and relevant to staff.

I found that the Office is open and accountable about its performance. It has a sound approach to determining its strategic objectives, in ensuring that its activities are consistent with those objectives and in managing its performance. However it could benefit by more extensively benchmarking its performance against other audit offices.

As with any wide-ranging review of this nature, areas will be identified where improvements could be made. This Report makes a number of recommendations to assist the Office in addressing changes necessary to further enhance the quality of its operations and relationships. These recommendations (and the Auditor-General's responses) are contained throughout the report and are set out in full in Appendix 4.

The Terms of Reference also required me to "assess ... the relevance and appropriateness of the *Auditor-General Act 1996* to facilitate delivery of better practice audits". I have made some specific recommendations relating to the frequency of these independent reviews of the Office and how they should be commissioned, and included some discussion about the power to 'chase the dollar' in auditing government programs.

1 To avoid confusion with audits undertaken by the ACT Audit Office, I have used the term 'Review' in this Report to refer to this performance audit of the Office.

Audit Office's Response: The Audit Office welcomes the overall conclusion of the independent review that the Office's operations are efficient and effective and achieve value for taxpayers' money. The review has identified many positive aspects of the Office, including its openness and accountability, the comprehensiveness of policies and procedures, high quality of its reports, high staff productivity, and its strong commitment to meeting better practices under the new professional standards.

The Office also welcomes the opportunities to improve aspects of its operations as recommended by the independent review. Consistent with its commitment to continuous improvement, the Office will promptly implement the 'agreed' recommendations from the review.

2. BACKGROUND TO THE REVIEW

2.1 The Engagement

In most Australian jurisdictions there is a legislative requirement for a periodic review to be undertaken of the jurisdiction's audit office. This is seen as being part of good governance, to ensure that the legislature and audited entities are being provided with good quality advice and services.

Where these reviews are undertaken, they are usually commissioned by the parliamentary Public Accounts Committee. In the Australian Capital Territory, Part 5 of the *Auditor-General Act 1996* sets out the provisions governing both the review (or "performance audit" as it is termed in the Act) and the annual audit of the financial statements of the Auditor-General's Office.

Section 27 of the Act provides that "The Minister ... may engage a person under a contract to conduct an audit under this part". On 23 December 2009, invitations were issued by ACT Procurement Solutions (on behalf of the Chief Minister's Department) for parties to tender for the performance audit. As a result of the tender evaluation process, Bob Sendt Consulting Pty Ltd was selected to undertake the Review, with Bob Sendt² being the principal reviewer. On 19 February 2010, I received a written request from the Chair of the ACT Public Accounts Committee under section 29 of the Act, to conduct the Review.

The Terms of Reference for the Review are included in full as Appendix 1.

2.2 Approach to the Review

The Review was conducted in accordance with the Terms of Reference and the relevant provisions of the Act.

It was undertaken using a combination of interviews with key stakeholders of the Office, reviews of Audit Office documentation (electronic and physical) and numerous meetings and discussions with the Auditor-General and her senior staff. Face-to-face or telephone interviews were held with a sample of the key stakeholders of the Office, including the Public Accounts Committee, other Members of the Legislative Assembly, Chief Executives and other senior staff of Government entities, and Audit Office staff (in their capacity as employees).

Documentation reviewed included:

- financial and performance audit files
- documentation relating to the systems and methodologies used by the Office in undertaking its financial and performance audits
- documentation relating to the internal management of the Office
- published reports to Parliament.

² Bob Sendt was the Auditor-General of New South Wales from 1999 to 2006.

The Review took into account the key requirements of Australian auditing and assurance standards and accounting professional and ethical standards that should be met by the Office in undertaking its audits. The key requirements were identified as the following (not all are applicable to both financial and performance audits):

- audit planning
- risk assessment
- use of internal audit
- consideration of fraud
- consideration of compliance with laws and regulations
- communication with those charged with governance
- documentation
- quality control.

While external standards generally apply regardless of the size of the audit practice (ie the audit firm or audit office) or the individual audit, the standards are written in a 'principles-based' style, ie they set down more the outcomes to be achieved, rather than mandating detailed processes to be followed. Hence audit practitioners have scope to develop and apply their own policies, methodologies and practices in carrying out their audit functions.

Because of this, in carrying out the Review I was conscious of the scale of operations of the ACT Audit Office. That is, I was conscious that what may have worked well in a large audit office was not necessarily the right solution for one that was much smaller³. I would emphasise however that this approach to the Review did not involve setting the 'bar' lower in terms of adherence to the standards themselves.

2.3 About this Report

This report is structured broadly along the lines of the Terms of Reference (see Appendix 1). However I have combined Terms 1 and 3 as there seemed to be considerable overlap between the two terms. I considered that no useful purpose would be served in duplicating material between two sections, or requiring the reader to continually cross reference between the two.

Prior to its finalisation of this Report, a draft was provided to the Auditor-General. This allowed her to identify any errors that I may have made, to 'challenge' any draft findings by providing additional evidence and also (as allowed for in the legislation) to submit any written comments that I must take account of in finalising the Report. Where the Auditor-General did provide formal written comments, I have identified them in the Report as responses to my findings and recommendations.

3 The ACT Audit Office has around 33 staff; the NSW Audit Office has around 250 staff.

2.4 Acknowledgements

On behalf of the Review team, I would like to acknowledge the willing cooperation and assistance received from the Auditor-General and staff at all levels in the Audit Office. Much time was spent by them in putting together background information for the Review, in meeting our numerous requests for additional data and in discussing issues with us as they arose.

As part of the Review, I also met with the Public Accounts Committee and a number of the Office's stakeholders, including Members of the Legislative Assembly and Chief Executives and other senior staff of government agencies, and staff of the Office. Without exception, they all gave readily of their time and were prepared to discuss their views of the Office candidly and openly.

I must also acknowledge the substantial assistance I received in conducting this Review from Mr Mark Abood, a former Principal Auditor with the New South Wales Audit Office.

3. THE OFFICE'S AUDIT METHODOLOGIES AND PRACTICES

3.1 Overview

There are a number of external requirements that govern how the Audit Office should operate.

First, and in a real sense pre-eminent, are any requirements set out in the ACT *Auditor-General Act 1996*. However the Act, like similar legislation in other Australian jurisdictions, recognises the independence and rather unique role of an auditor-general. It deals largely with the role and powers of the Auditor-General, and imposes very few restrictions or requirements on how the role is to be undertaken.

Second, there are various bodies of standards that apply to auditors in Australia.

'Force of law' auditing standards were introduced in Australia from 1 July 2006⁴, placing stricter requirements on auditors in the way they conduct audits. These standards, issued by the Auditing and Assurance Standards Board⁵, have placed a greater emphasis on audit documentation, auditor independence and quality control within audit practices. All members of the three major Australian accounting bodies⁶ are required to comply with these standards.

In addition, members of the major Australian accounting bodies are bound by the standards issued by the Accounting Professional and Ethical Standards Board⁷ (set up by the three accounting bodies). The most relevant standard in the context of this Review is APES 320 *Quality Control for Firms* ('firm' is defined in the standard to include an Auditor-General's Office). APES 320 as originally issued took effect from July 2006, with an updated version taking effect on 1 January 2010.

APES 320 applies to the members of all firms providing accounting services (including auditing services) in Australia. It contains many detailed requirements, but the two overarching requirements are as follows:

3. A firm shall establish and maintain a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and that reports issued by the firm or engagement partners are appropriate in the circumstances.
10. A firm shall establish and maintain a system of quality control that includes policies and procedures that address each of the following elements:
 - (a) leadership responsibilities for quality within the firm
 - (b) relevant ethical requirements

4 Strictly speaking, while auditing standards apply to all audits, the 'force of law' backing to those standards only applies to audits or reviews of financial statements required under Part 2M.3 of the *Commonwealth Corporations Act 2001*. Few audits undertaken by the ACT Audit Office would fall in this latter category.

5 The AUASB was established in 2004 as an independent Commonwealth body, replacing a body of the same name operating under the joint auspices of the Institute of Chartered Accountants in Australia and CPA Australia. Bob Sendt was a continuing director of the AUASB from 2001 to 2005.

6 The Institute of Chartered Accountants in Australia, CPA Australia and the National Institute of Accountants.

7 Bob Sendt is a director of the APESB.

- (c) acceptance and continuance of client relationships and specific engagements
- (d) human resources
- (e) engagement performance
- (f) monitoring.

As can be seen from the above, APES 320 is not just about auditing. It is about ensuring the entire audit practice (ie the Audit Office) is well-managed in all key aspects. The importance of APES 320 (and its international equivalent ISQC1) in mandating higher minimum quality control standards - particularly in audit firms - cannot be overstated.

It was originally introduced at a time when the quality of individual audits and the quality control of audit firms were being questioned as a result of numerous major corporate failures such as HIH, One.Tel and Harris Scarfe in Australia, and Enron, WorldCom, Vivendi and Parmalat overseas. Together with the more rigorous auditing standards introduced at the same time and amendments to the *Corporations Act*, it has had major impacts on the way audit firms operate. At the time of the introduction of the various new requirements, a view often expressed by partners of the 'Big 4' audit firms in Australia was that it would add an additional ten per cent to audit costs.

To assist in meeting the new requirements of APES 320, ACAG (the *Australasian Council of Auditors-General*) sponsored the development, mainly by the Victorian Auditor General's Office, of a 'self-assessment tool' that member audit offices could use.

As described by ACAG, the tool (the *Governance and Audit Framework for Self Assessment and External Review*) has been "developed and agreed through reviewing comparative models which include the Australian Business Excellence Framework, the Australian Stock Exchange Principles of Good Corporate Governance, and the SAI-Global ISO program".

The tool comprises four sections:

- Office governance
- audit practice standards
- financial audit
- performance audit.

The first two of these sections deal with 'whole of practice' issues; the last two deal with individual audits.

Within each of the first two sections there are 6 'areas' identified for assessment. For example within Section 2 (*Audit Practice Standards*), the 6 areas correspond to the 6 elements mandated by paragraph 10 of APES 320 (see above).

Within each 'area' there are in turn a number of criteria or 'considerations' against which an audit office can assess its status. How an audit office assesses itself (or is assessed) against each of these considerations leads to a rating which determines whether the office has reached the level consistent with the APES 320 requirements.

Finding: In implementing a new system of quality control to meet new standards, the Office has adopted a professional and thorough approach.

The ACT Audit Office has placed great importance on achieving and maintaining APES 320 compliance and has used the ACAG tool to assist it to do this⁸.

The Office allocated one of its Senior Audit Managers to take primary responsibility for the project over the calendar years 2008 and 2009. While not full-time on APES 320 implementation over that period, it consumed a large part of his time. Other staff at Senior Manager, Manager and Senior Auditor level also assisted in various aspects of the project.

The outcome of this effort has been both a very comprehensive *assessment* of the Office's compliance with APES 320 (running to some 56 A3 pages, plus two lever arch folders of supporting evidence) and, more importantly in my view, the creation and adoption of substantially more robust *systems* by which the Office operates. It was clear from the quantum of new policy and procedure documents developed during this process that the Office took the APES 320 requirements seriously.

In committing to this project, the Office acknowledged the extent of resources it would consume. The Office sought additional budget funding but, when this was refused, funded the costs from its existing budget appropriation, in effect diverting resources from the other activities, including the performance audit program, that are wholly reliant on the appropriation.

In my view it would have been more appropriate for the Office to have apportioned the overall cost of the APES 320 project between financial audit and performance audit. The share relating to financial audit could then have been recouped through increases in the fees charged to financial audit clients, perhaps over a 3-year period. This issue is discussed further in Section 5.4.

3.2 Financial Audits

3.2.1 General Findings

Finding: The Office's financial audit function is generally well-managed and professional.

Finding: Some aspects of the conduct of financial audit, particularly in relation to audit evidence, documentation and quality control, require attention to ensure full compliance with audit standards and the Office's own policies.

Audit Office Response: The Office will give further attention to its work in these areas, as part of the quality review processes applied to financial audit work and in training provided to staff.

8 While the tool is primarily designed for assessment purposes, the 'considerations' it contains in effect provide a substantial body of guidance on what systems, policies and practices need to be in place to achieve compliance.

The Office has responsibility for some 70 annual financial report audits, of which around 60 are undertaken within the Office, the remainder being contracted to private sector audit firms.

Responsibility for undertaking these audits within the Office falls to the Financial Audit group which consists of approximately 23 staff⁹. The group is headed by the Director, Financial Audits, but the Auditor-General also has significant involvement in respect of the larger, more complex clients. The Financial Audit group is also responsible for managing the audits that are contracted to private sector audit firms.

The introduction of ‘force of law’ auditing standards from 1 July 2006 placed a greater focus on audit documentation, auditor independence and quality control reviews.

The ACT Audit Office uses an electronic financial audit methodology known as IPSAM (“Integrated Public Sector Audit Methodology”). IPSAM was largely developed as a co-operative venture between the Victorian and Queensland Audit Offices and was subsequently adopted by the Tasmanian and ACT Audit Offices.

Based on the work we undertook as part of this Review and our previous similar review of the Tasmanian Audit Office, we believe that the IPSAM financial audit methodology used by the ACT Audit Office adequately addresses the requirements of the auditing standards. That is, an audit practice that uses IPSAM and applies the audit methodology it specifies to the audits of financial statements (and has an adequate quality control system at the ‘whole of practice’ level), should satisfy the requirements of the relevant Australian audit standards.

To test how well the requirements of IPSAM and the external auditing and quality control standards had been met, the Review examined a sample of 6 audit client files (see Appendix 2). These consisted of a mix of smaller vs larger agencies, departments vs business undertakings, and in-house vs contracted audits.

We reviewed the files to examine whether the conduct of those audits by the Office complied with the IPSAM methodology, relevant auditing standards and the APES 320 quality control standard.

From our review of the selected files, we concluded that in most cases the audit methodology was applied appropriately, and in a way that met the requirements of the auditing standards. However (as set out in the *Detailed Findings* section below), improvements are considered warranted in some areas including documentation, audit sampling, analytical reviews, and quality control.

From 1 July 2008, the Audit Office changed from having external peer reviews of its financial report audits (undertaken by the Tasmanian Audit Office) to independent internal quality assurance reviews. That internal review of audit work files for 2008-09 was completed recently and findings were still being collated at the time of this Review. The Office has advised that it intends for future quality assurance reviews to be ‘instant reviews’ conducted shortly after completion of each segment of audit work.

9 At the less senior levels, staff are not assigned exclusively to specific business units but may work on financial audits, performance audits or corporate activities.

3.2.2 Detailed Findings

3.2.2.1 Engagement Quality Control Reviews

Finding: The Office has not formally determined that any of its audits should be subject to a quality control review as provided for in APES 320 *Quality Control for Firms*.

APES 320 requires (paragraph 70) that audit practices establish an ‘Engagement Quality Control Review’ process for all audits of listed entities (not relevant for the Audit Office) and for any other audits that the practice determines ‘appropriate’. ‘Appropriate’ is not defined but is usually taken to mean entities that are significant - by size, nature or extent of public interest.

The Office has not formally determined any of its audits as ‘appropriate’ for this purpose. Nor, strictly speaking, does APES 320 require it to do so. However we would have expected that, as a matter of good practice, the Office would have identified a number of its more significant audits as needing to come under the APES 320 process.

Where an APES 320 quality control review is to be performed, the practice must appoint an ‘Engagement Quality Control Reviewer’ to undertake that role. A person carrying out that role cannot be part of the team involved in the audit being reviewed and the role is distinct from the normal reviews that are undertaken *within* the audit team (ie the review by senior team members of the work of junior team members). Paragraph 72 of APES 320 requires that the audit opinion must not be signed until the Engagement Quality Control Review is completed.

The Office’s Director of Financial Audit does review all audits prior to the Auditor-General signing the audit opinions. The Office’s Technical and Quality Assurance Manager also has a role in assessing the Office’s adherence to quality standards.

While both of these roles are positive actions the Office takes in maintaining audit quality, in our view neither would currently constitute an Engagement Quality Control Review for APES 320 purposes. Because the Director of Financial Audit reviews all audits, we believe that the depth of each review would not meet the APES 320 requirements. And the reviews undertaken by the Technical and Quality Assurance Manager are not (to date) completed prior to the issue of each agency’s audit opinion.

Recommendation 1: The Office should identify which of its audits are to be subject to an APES 320 quality control review and redesign its processes to allow such reviews to be undertaken before each audit opinion is issued.

Audit Office Response: Agreed. The implementation of an APES 320 Engagement Quality Control Review process for selected audits reflects better practice, and would enhance the review processes currently adopted by the Office.

3.2.2.2 Audit Sampling

Finding: Audit sampling was performed at an interim date for most engagements. It was unclear in the audit documentation as to what further substantive procedures or substantive procedures combined with tests of controls were performed during the remaining period that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.

Audit Office Response: The Office considers the current approach to testing is sound and complies with the relevant auditing standards. However, the Office agrees it could have documented more clearly in the audit files the rationale for not extending sampling to cover the 'intervening period'. The instances where sample testing was not extended to cover the 'intervening period' between the completion on the interim work and the end of the reporting period, occurred when the Audit Office considered that this task was not necessary to gather sufficient and appropriate evidence to support the audit opinion.

It is impracticable for an auditor to review 100 per cent of items within a class of transactions or account balance. Audit sampling is a process that allows an auditor to apply audit procedures to less than 100 per cent of the population such that each unit has a chance of selection. The auditor can obtain and evaluate audit evidence about some characteristic of the items selected in order to form a conclusion concerning the population from which the sample is drawn.

It was noted in several of the files that we reviewed that the Office's audit sampling did not cover the full financial year (ie total population).

In some cases, testing was conducted on transactions from only the first half of the financial year. In other cases, sampling only covered the period up to the time of the interim audit (initial audit normally completed prior to the end of the financial year). The intervening period, generally May and June, was not included in the sample. There was no clear indication in the audit working papers of audit procedures performed in the intervening period.

Recommendation 2: The Audit Office should ensure that, where audit sampling for tests of controls and/or substantive procedures is performed at an interim date, clear evidence is included in the audit file outlining the audit procedures undertaken to cover the remaining period.

Audit Office Response: Agreed.

3.2.2.3 Variance Analysis

Finding: The Office's analysis of significant variances between current and prior period balances did not always adequately explain the reason for the variance. This does not meet the requirements of Auditing Standard ASA 520 *Analytical Procedures*.

Variance analysis is an analytical procedure used by auditors to identify accounting aggregates (eg payroll, revenue, debtors) where additional audit attention might be warranted. It involves comparing the value of an aggregate with previous periods or with other related aggregates to identify 'variances' from expected or normal patterns. For example a significant increase in payroll costs might reflect a legitimate reason (additional staff recruited to take on a new function), an error (a transaction incorrectly coding to payroll), or a fraud ('phantom' employees being added to the payroll).

Where variances exceed expected results, the auditor is required to investigate and obtain adequate explanations and appropriate corroborative audit evidence. From our examination of selected audit files, we observed that on some occasions the analysis documented in the file did not adequately explain the variance or the nature of the corroborative audit evidence.

It would assist the analytical review process if agency management provided audit staff with explanations of all significant variances in income and expense balances. This could be provided by the agency at the same time the draft financial report is provided for audit. The 'threshold' amount or percentage variance requiring explanation could be agreed with agency management in advance and included in the audit strategy.

Audit documentation supporting an analytical review of account balances should provide an adequate explanation for variances that exceed the Audit Office policy threshold.

Recommendation 3: The Audit Office should consider including in the audit strategy a requirement for each agency to prepare a document explaining significant variances from previous year balances. The threshold variance amount or percentage requiring explanation could be agreed with each client.

Audit Office Response: Agreed. The Audit Office notes, however, that the suggested approach will require the cooperation of reporting agencies and, to be effective, agencies will need to have properly analysed their results prior to providing the requested information.

Recommendation 4: Analytical reviews comprising comparison of current year with prior year balances should be adequately explained in the audit file.

Audit Office Response: Agreed. The Audit Office will ensure documentation in this area is improved.

3.2.2.4 Review of Agencies' Draft Annual Reports

Finding: Agencies' draft annual reports were not always reviewed in a timely manner. This does not allow for any errors or inconsistencies identified by the review to be amended in the annual report before it is published.

Audit Office Response: The Audit Office reviews all printed annual reports and website versions shortly after the date by which these annual reports are required to be tabled (30 September) and advises agencies of any significant errors for correction.

The Office does not believe this has presented a risk to reporting as there has been a very low number of inconsistencies identified from the Office's subsequent review of published annual reports and these have all been promptly rectified.

It is part of an auditor's role to ensure that the audited financial statements and audit opinion are accurately and completely reproduced in the entity's annual report, and that information included elsewhere in the annual report is consistent with the financial statements. This requirement is set out in Australian Auditing Standard ASA 720 *Other Information in Documents Containing Audited Financial Reports*.

ASA 720 requires the auditor to arrangements with the client to allow a review of the agency's draft annual report prior to the issue of the audit report. Where the draft is not available by that date, ASA 720 requires the auditor to review the report as soon as practicable. In our view this implies a review before the annual report is published, to identify any material inconsistencies and enable them to be amended prior to publication.

We appreciate that ACT agencies' annual reports need to be tabled in the Legislative Assembly by 30 September and this imposes a tight deadline on the agencies and the audit teams. We note that, as part of the audit planning process each year, the Audit Office advises agencies of its requirement to review their annual reports and their responsibility to ensure that the printed and electronic (website) versions of their annual reports include the correct version of its audited financial statements.

However in the audit files we examined, the review of other information by the Audit Office was not performed until after publication of the annual report. For one agency, this review identified significant discrepancies, requiring amendments to the financial report on its website and a corrigendum to Parliament.

Where in exceptional circumstances the draft annual report cannot be reviewed prior to publication, the auditor should document these circumstances in the audit file.

Recommendation 5: The Audit Office should remind audit teams of the need to liaise with those responsible for preparing the annual report to ensure the team is provided with a draft in a timely manner prior to publication. In exceptional circumstances where this cannot be arranged the auditor should clearly document the reasons in the audit file.

Audit Office Response: Agreed. The Office already requests, as part of the annual audit planning process, that agencies provide their draft annual reports to the Office for review prior to the issue of the audit report. The reporting agencies have not been able to comply with this request and this is most likely due to the tight timeframe for the tabling of annual reports in the ACT. Where agencies do not provide the draft annual report as requested, the Office will now document the reasons in the audit file as recommended by the independent auditor.

3.2.2.5 Audit Documentation

Finding: Instances were noted where the documentation of the basis for the audit conclusion(s) needed to be improved, particularly where exceptions were identified in the sample being tested.

Audit Office Response: The Audit Office believes that the audit conclusions reached were sound, but acknowledges that documentation of the basis for these conclusions could have been better in the instances of exceptions identified by the independent auditor.

Our review of the Audit Office's audit files indicated that the necessary audit evidence was generally obtained, but was not always documented in the audit files. This particularly related to exceptions arising from audit sampling of controls and tests of details. Exceptions often included missing agency documents or the absence of a signature by the agency's preparer or review officer. One exception related to an officer who significantly exceeded his expenditure delegation. There was little evidence in the audit files as to how these exceptions were taken into account in arriving at the conclusions reached or judgements made.

The Audit Office should also clarify its practices where a transaction sampled cannot be reviewed (eg if the documentation relating to that transaction is missing) or was inappropriately included in the population (eg a previously exited employee was left in the annual and long service leave populations, with nil balances).

Recommendation 6: Financial audit staff should be reminded of the importance of ensuring sufficient and appropriate audit evidence on exceptions is documented in the audit files to support the conclusions reached.

Audit Office Response: Agreed.

3.2.2.6 Documentation of Audit Team Debriefings

Finding: Audit team debriefing meetings were not always documented to the extent required by the Office's IPSAM audit methodology.

While the IPSAM audit methodology generally provides for the documentation of audit team debriefing meetings, in some cases documentation of these meetings was lacking in detail.

No provision for these meetings is included in the "small audit" pack (ie that component of the IPSAM methodology designed for audits of smaller agencies). We noted that this pack was used for the audits of the Gambling and Racing Commission (audit fee \$22,400) and Community Housing Canberra Ltd (audit fee \$22,000). In our view these audits are large enough to warrant a team debriefing.

Audit Office team debriefings should be fully documented, including as a minimum the date of the meeting, attendees and issues discussed.

Recommendation 7: The Office should remind audit teams of the need to ensure that audit team debriefing meetings are adequately documented.

Audit Office Response: Agreed.

Recommendation 8: The Office should consider holding team debriefings for small audits.

Audit Office Response: Agreed.

3.3 Performance Audits

3.3.1 General Observations

Finding: The Office's performance audit function is generally well-managed and effective, and meets the requirements of ASAE 3500 *Performance Engagements*, but there is scope for attention to some aspects.

Audit Office Response: The Office will give further attention to its work in the areas identified by the independent reviewer as part of its continuous improvement and quality review processes and in training provided to staff.

Unlike the audit of government entities' annual financial reports, the role of conducting performance audits is one that has only been given to auditors-general in comparatively recent times. Self-government in the Australian Capital Territory broadly corresponded with the period in which performance audits were being introduced in a number of other Australian states¹⁰ and the mandate was included in the ACT Auditor-General's powers from the inception of the position.

Performance audits often result in controversy. By their nature, they have the capacity to cause embarrassment to those who have responsibility for the service being reviewed. The audit findings may expose shortcomings in the performance of government entities (and, potentially, in actions and decisions made by ministers and the government). Natural reactions in these circumstances may include rejection, denial and denigration.

The potential for such reaction means that performance audits should be conducted and reported on in a way that eliminates (or at least substantially minimises) the possibility of the findings themselves being flawed or open to genuine criticism. If this is not done, auditors-general are exposed to the risk of loss of credibility and authority. From my experience and discussions with other holders of these positions, I believe that auditors-general are well aware of the particular risks associated with performance auditing. Most would spend a greater proportion of their time on this aspect of their offices' work than mere staff numbers, etc would suggest.

Based on my review of a sample of performance audit files and published reports¹¹ and discussions with external stakeholders (including some government entities the subject of a performance audit), my opinion is that the ACT Audit Office performs this function well. This is particularly so given the inherent difficulties associated with the relatively small size of the Office's performance audit resources and the heavy turnover of staff that the Office has experienced in recent years.

Aspects of the performance audit function that I particularly considered to be sound included the topic selection process (see Section 4), the creation of an Audit Work Plan at the outset of each audit, the robustness of the new *Performance Audit Methods and Practices* (PAMPr) Manual and the comprehensiveness of evidence that I observed.

Overall I believe that the ACT Legislative Assembly and the public obtain a valuable and professional service from the Office for the funds allocated to it for undertaking performance audits. The findings and recommendations I have made in the ensuing pages do not diminish this opinion.

¹⁰ Some Australian states have yet to legislate to allow for performance audits.

¹¹ See Appendix 3 for a list of performance audits reviewed.

3.3.2 Performance Audit Methodology

Finding: The Office's move to a new performance audit tool ('ASPIRE') is appropriate and should strengthen confidence in the Office's quality control and compliance with auditing standards.

Finding: The Office's new *Performance Audit Methods and Practices* (PAMPr) Manual provides a robust set of policies, practices and guidelines for the conduct of performance audits.

All small audit practices face difficulty in ensuring they have robust audit systems and methodologies in place. Proprietary software packages and associated methodologies are available but these are not always appropriate to public sector audit offices, particularly in regard to performance audits.

Apart from the relevant provisions of the *Auditor-General Act 1996*, the main external requirement that the Audit Office must comply with is the Australian Standard on Assurance Engagements (ASAE) 3500 *Performance Engagements*. This standard, issued by the Auditing and Assurance Standards Board applies to performance engagements commencing on or after 1 January 2009 and replaces two former standards - AUS 806 *Performance Auditing* (July 2002) and AUS 808 *Planning Performance Audits* (October 1995).

As indicated elsewhere in this Report, the Queensland and Victorian Audit Offices jointly developed an electronic financial audit package known as IPSAM. The ACT and Tasmanian Audit Offices subsequently introduced IPSAM for their financial audit function.

While IPSAM was originally designed for financial audits, it has since been substantially adapted by the Queensland Audit Office to provide the functionality required for performance audits. This new product is known as 'ASPIRE'. ASPIRE is essentially a Lotus Notes based tool that automates the management of evidence and working papers for individual audits but with the ability to reference to overarching audit policies, practice statements and templates.

Currently the Office does not have an electronic tool that serves this purpose, but has decided to adopt ASPIRE. The Office is currently undertaking the customisation needed to meet its own requirements (eg building the links within ASPIRE to its own policy and practice documents) and will be trialling it with a number of performance audits commencing in the next few months.

As ASPIRE is not yet in use in the ACT Audit Office, I did not see it as appropriate for the purposes of this Review to examine it in great detail. However the nature of auditing (financial and performance) is such that an enormous amount of documentation (both 'evidence' and working papers) is created. Maintaining this documentation in a structured manner is one of the key challenges auditors face. I would therefore support the Office's decision to move to a modern automated working papers tool bespoke-built for performance auditing.

The recent Strategic Review of the Queensland Audit Office (report date 3 March 2010¹²) specifically examined ASPIRE against the requirements of Australian Auditing Standards and in particular ASAE 3500 *Performance Engagements*.

12 See www.gao.qld.gov.au/downloadables/publications/auditor_general_reports/2010_Report_No.3.pdf

The Queensland review concluded that “overall the ASPIRE methodology complies with the requirements outlined in Australian Auditing Standards”.

However the Strategic Review report (pp48-49) identified a number of issues where it believed ASPIRE need strengthening. Before implementing ASPIRE in the ACT, the Audit Office should investigate whether these issues need to be addressed.

Recommendation 9: The Office should examine the issues identified by the recent Strategic Review of the Queensland Audit Office as to improvements needed to make ASPIRE fully functional.

Audit Office Response: Agreed. The Audit Office will obtain information on the issues relevant to ASPIRE identified during the Strategic Review of the Queensland Audit Office and consider their relevance to the introduction of the methodology in the ACT.

Apart from its commitment to ASPIRE, the Office has also invested heavily over the last year in developing a comprehensive performance audit practice manual known as PAMPr. PAMPr is an electronic procedures manual that covers all aspects of performance auditing from program planning to post-audit follow-up.

To quote from the PAMPr Foreword:

The policies and procedures in PAMPr are an important step in ensuring the Audit Office delivers against its strategic goals. To do so, the Audit Office must consistently provide high-quality performance audit services, which meet professional requirements and stakeholder expectations. PAMPr aims to facilitate this.

PAMPr consists of 7 parts, as follows:

- Part 1 Foundation Policies and Procedures
- Part 2 Strategic Planning
- Part 3 Audit Planning and Engagement
- Part 4 Implementation
- Part 5 Reporting
- Part 6 Publication and Post-tabling
- Part 7 Follow-up

To quote from PAMPr again, each of its 7 Parts provides:

- a concise and clear statement of policy in relation to the specific aspects of a performance audit;
- practice statements, which relate the policies to specific practices; and
- guidance on the application of the policies and practices. Where relevant, the guidance references templates for various documents to encourage consistency in use and application.

PAMPr runs to over 270 pages in total. It was developed from the existing policies and practices of the Audit Office, but took into account similar documents from the Queensland, Victorian and Australian National Audit Offices, as well as a number of international audit offices.

In my view PAMPr is extremely comprehensive, well-structured and well-written. As it has only recently (December 2009) been formally adopted, the challenge for the Office now will be to ensure that it is fully integrated into the way staff approach the individual daily aspects of their performance audit work.

3.3.3 Conduct of Performance Audits

(See Section 4 for discussion of the process for selecting performance audit topics.)

3.3.3.1 Audit Documentation and Conclusions

Finding: Documentation on individual performance audit files was generally maintained at an appropriate standard and audit findings reflected the evidence obtained.

As part of the Review, I examined in some detail the electronic and physical files of the evidence and working papers associated with 3 performance audits undertaken over the last 2 years. These are the first 3 shown in Appendix 3. (For the 4th audit - Government Office Accommodation - I reviewed only the electronic files.) In some instances where I wanted to test a particular issue I had identified, I also examined how it had been managed in a selection of other audit files.

For each of the audits, the level of documentation was substantial. It included not only material obtained from the agency or agencies under review (published and unpublished), but material from other audit offices that had undertaken similar performance audits, from commissions of inquiry or other external reviews (ACT and interstate), from debates in the Legislative Assembly, media clippings, etc.

In the case of the *Delivery of Ambulance Services* audit for example, there were 16 physical files of evidence and background papers totalling over 2,000 pages. Electronically, there were 78 folders comprising over 1,400 files and totalling almost 9 gigabytes.

Quantity of documentation is itself no guarantee of a properly-conducted audit or soundly-based conclusions, and the Review also examined the linkages between the audit findings and the evidence held.

While each of the audit files showed a slightly different approach to recording these linkages (some used a physical reference, some an electronic link), I was satisfied that each demonstrated a sound basis for all significant published audit conclusions. I did note that there could be improvements in the process for signing off workpapers but I believe that this should be dealt with once the new performance audit methodology is implemented.

The files also showed the extent of consultation with the agencies concerned and the changes that had been made to the various drafts as a result of agency feedback. The files also showed where agency comments or arguments had not been accepted and the reasons. There was clear evidence that all matters of significant disagreement were raised with the Auditor-General on a timely basis.

3.3.3.2 Identifying Key Issues

Part 5 of PAMPr deals with the preparation of ‘discussion papers’ as part of the audit process. It states:

At various stages during an audit, it may be useful for the audit team to prepare papers outlining significant issues that have emerged during an audit, either as an internal briefing tool, or as a means of communicating such matters to the responsible agency officers.

Discussion papers are a way of presenting observations to the auditee for comment as they arise, and they are often developed as an iterative process during the fieldwork phase of the audit.

PAMPr encourages but does not mandate the use of discussion papers. From the selected audit files I examined, there appeared to be variation in the extent to which they were used and their level of detail.

The advantage of providing a discussion paper (or ‘issues paper’ as they are referred to in some audit offices) is that it can help identify and resolve conflicts or disagreements between the Audit Office and the agency at an early stage in the audit process.

In some files I reviewed, there were no discussion papers identified as such. In others, the discussion paper took the form of an early draft report. In my view the draft report stage is too late in the audit process to notify agencies of the issues that the Audit Office may see as important. It creates the potential for the auditor to be (or be seen to be) ‘locked in’ to a particular view or for the agency to be placed under undue pressure in having to quickly develop arguments or garner evidence countering the draft report.

I believe it is good practice for audit issues, particularly where they may result in a critical or adverse finding, to be advised to agencies before the report drafting stage.

Recommendation 10: The Office should make it standard practice to provide agencies with a ‘discussion paper’ before substantial report writing commences, to aid earlier resolution of any differences of opinion between the Office and the agency concerned.

Audit Office Response: Agreed. The Audit Office already offers auditees an early opportunity to resolve differences of opinion, by communicating findings to the audited agencies throughout the audit as they arise, and providing reasonably comprehensive discussion papers or draft reports for discussion.

This approach generally offers auditees more information and context than a list of issues, and allows a more constructive discussion with the auditee focussed on key concerns. The Office typically conducts an exit meeting with auditee representatives, centred on the discussion papers or draft reports, to resolve differences in opinion or reported ‘facts’ before a proposed report is produced.

3.3.3.3 Controlling Costs and Time

Finding: Final costs of some performance audits over the last 3 years were substantially in excess of estimated costs, and there were some significant delays in their tabling.

Audit Office Response: The Office acknowledges that ideally there should be a reasonably close match between the initially estimated budget and timeframe for an audit and the final cost and tabling date. This, however, is not always feasible for a variety of reasons, especially given the constraints of a small audit team, and high staff turnover.

The initial budget approved with the early Audit Work Plan is based on factors known at the planning stage. The actual resource needs for the audit will be influenced by factors such as the complexity of the subject matter and administrative arrangements, the nature and quantity of the issues arising, the quality of the data available to audit, and at times the relationship with the auditee. These factors generally only come to light as the audit progresses and will often have a significant bearing on the cost of completing an audit and the timing of the audit.

The Office supplied the Review with information showing the final cost and original approved estimate of each of the 18 performance audits completed from the beginning of 2007 to the end of 2009.

On average, the final cost per audit was 37 per cent above the original estimate, with individual variances ranging from (-) 55 per cent to (+) 96 per cent. Only 5 audits had variances less than (\pm) 30 per cent.

As costs are largely made up of staff time, this reflects additional resources having to be allocated to the audits. With a relatively small (and largely fixed) complement of staff, this has resulted in delays in completing the individual audits, and with 'knock on' effects to the overall program.

The Office attributed these cost over-runs largely to a combination of staff turnover and scope changes.

The Office's high rates of staff turnover in recent years have been particularly pronounced in the performance audit area. In part this reflects the high demand in Canberra for the types of analytical skills that are held by performance auditors, particularly in the first term of a new Commonwealth government. Related to that is the inability of the Audit Office (and perhaps other Territory agencies) to match salary levels in the Commonwealth Public Service and the private sector.

However scope changes are within the control of the Office. While it is almost inevitable that the scope of individual performance audits will need refinement over the course of the audit, a small number of agency CEOs and senior staff did express to me their concern at the extent of scope changes that had occurred.

The Office conducts a post audit review for all performance audits. Where the cost or timeframe for the audit has varied significantly from the approved *Audit Work Plan*, the review identifies contributing factors. Where scope variation is a contributing factor, the review seeks to identify whether it was due to foreseeable circumstances which could have been recognised at the planning stage, or whether other factors have intervened.

The time allowed for this Review did not permit a detailed assessment of the extent of scope changes, their rationale, or their contribution to overall cost over-runs. However this is an issue that warrants further investigation by the Office to see if the scope changes reflect any shortcomings in the initial scoping methodology.

Recommendation 11: The Office should review its existing approaches to audit scoping and to scope changes to identify any improvements that may be warranted.

Audit Office Response: Agreed. As a standard practice, a post-audit review is conducted for performance audits, with input from the Auditor-General, Director, and audit team, to identify areas of improvement (in policies, procedures, or accepted practice), for application to future audit activities.

3.4 Appropriateness of the Provisions of the *Auditor-General Act 1996*

The terms of reference for the Review require me to assess “the relevance and appropriateness of the *Auditor-General Act 1996* to facilitate delivery of better practice audits”.

At the same time, the Legislative Assembly’s Public Accounts Committee has commenced an inquiry into the Act, with wide-ranging terms of reference.

It is not my intention, nor was it (I believe) the Public Accounts Committee’s intention that my Review attempt to duplicate the Committee’s inquiry. However there are a number of issues that I have identified arising in the course of my Review that might be of relevance to the Committee’s work. These are as follows.

3.4.1 Frequency of the Review

In jurisdictions where these types of reviews of audit offices are provided for by legislation, the legislation generally provides for them to be conducted with some degree of regularity.

For example in both New South Wales¹³ and Victoria¹⁴ the relevant legislation provides for a ‘review’ or ‘audit’ at least once every 3 years. In Tasmania¹⁵ and Queensland¹⁶ the review must be carried out at least once every 5 years. In Western Australia¹⁷, the review must be carried out every 5 years in conjunction with a review of the Act by the Joint Standing Committee on Audit.

13 Section 48A(1) of the NSW *Public Finance and Audit Act 1983*.

14 Section 19(1) of the Victorian *Audit Act 1994*.

15 Section 44(1) of the Tasmanian *Audit Act 2008*.

16 Section 68 of the Queensland *Auditor-General Act 2009*.

17 Section 48(3) of the WA *Auditor General Act 2006*.

By contrast, section 29 of the *ACT Auditor-General Act 1996* provides that “The independent auditor must conduct a performance audit of the operations of the auditor-general as soon as practicable after receiving a written request to do so by the presiding member of the public accounts committee”. It would appear that such a request can only be made if the Chief Minister has first appointed an ‘independent auditor’ under section 27 of the Act. Neither section of the ACT Act sets any frequency for the performance audit.

The last performance audit of the ACT Audit Office was conducted in 1998-99, following a May 1998 resolution of the Legislative Assembly.

Given the importance of the role of an auditor-general in the public accountability framework of government, I do not believe that an interval of a decade or more between external reviews is appropriate. I also believe that having a set interval removes any inference that the timing of a review has been influenced by extraneous factors. It also allows the review to be more planned and avoids any undue compression of the time allowed for the reviewer. (For the current Review, the elapsed time from the PAC request to the due date for submission to the Speaker was less than 11 weeks.)

In terms of a suitable interval between reviews, any review is ‘disruptive’ to the ongoing operations of an audit office, notwithstanding its benefits. From my experience, triennial reviews are too frequent, given that no other area of government is reviewed with such intensity or frequency.

Given that the Legislative Assembly is now subject to fixed 4-year terms, there may well be merit in adopting the same frequency, perhaps timing the review around the midpoint of each Assembly term. If this were adopted, the next review might then take place in 2014, which would be around 4 years from this Review.

I note that in its submission to the Committee’s inquiry into the *Auditor-General Act 1996*, the Office has proposed that the review should occur “at least once in the term of each Auditor-General’s seven-year appointment”. I would support this as a *minimum* requirement, but I believe a more regular review would be preferable.

Recommendation 12: In its inquiry into the *Auditor-General Act 1996*, the Public Accounts Committee should consider the merits of moving to a fixed interval between section 29 reviews of the Audit Office.

Audit Office Response: Supported. The independent reviewer’s recommendation is consistent with the suggestions made by the Audit Office in its submission to the Standing Committee on Public Accounts’ Inquiry into the *Auditor-General Act 1996*.

3.4.2 Commissioning of the Review

As indicated above, a review of the Audit Office can only occur at present if both ‘the Minister’¹⁸ and the chair of the Public Accounts Committee take action under sections 27 and 29 respectively.

18 Currently the Chief Minister.

Auditors-general are (formally or otherwise) ‘independent officers of parliament’ and should not be subject to direction by the executive arm of government. In the ACT, this independence is recognised in section 9 of the Act. While independent, the role of auditors-general is, to a great part, to support parliament in holding executive government accountable. In my view this makes it inappropriate for executive government to be involved in the decision-making process as to whether a review should occur.

Section 27 not only gives the Minister the ability to influence the timing of any review. In allowing the Minister to engage a person under contract to conduct the review, it appears also to give the Minister a substantial role in setting its terms of reference, as they form part of the contract’s terms.

In my view, the Public Accounts Committee should have sole responsibility for setting the terms of reference for the review and contracting with the reviewer. My understanding is that is the general practice in other Australian jurisdictions¹⁹ and in the United Kingdom.

Recommendation 13: In its inquiry into the *Auditor-General Act 1996*, the Public Accounts Committee should consider the merits of assigning full responsibility for setting the terms of reference for section 29 reviews and contracting with the reviewer to the Committee.

Audit Office Response: Supported. The independent auditor’s recommendation is consistent with the suggestions made by the Audit Office in its submission to the Standing Committee on Public Accounts’ Inquiry into the *Auditor-General Act 1996*.

3.4.3 ‘Chasing the Dollar’

Governments of all political ideologies are increasingly relying on third parties to deliver services that were once thought of as the exclusive domain of the ‘public service’. The arrangements that apply between governments and these third parties are varied, but the taxpayer and the general population are increasingly expecting that ‘value for money’ will be demonstrated.

Where an arrangement is substantially contractual in nature, it should be expected that the terms of the contract would adequately set out what was being delivered, the quality and timeliness criteria that apply and the resulting payment arrangements. This type of arrangement more typically applies to the provision of ‘goods’ rather than ‘services’.

But where the arrangement is more in the nature of a grant (rather than a true contract), it is often difficult to set out what is being provided in return with the same degree of certainty. This is particularly the case where the organisation receiving the grant is providing services that cannot be readily defined in terms of quantum, quality, etc or where the grant forms only part of the funding used by the recipient organisation to deliver the service.

¹⁹ However in Queensland these responsibilities are given to the Governor, presumably acting on the advice of Cabinet, ie executive government.

Performance audit mandates typically define the role of an auditor-general as being to audit a public sector ‘agency’ or ‘activity’. Where the agency provides grants to a non-government entity, the performance audit is largely restricted to examining how well the agency has managed the relationship. This may encompass tendering (if any), how well the service has been specified, what reporting mechanisms have been put in place, whether any penalty or reward system is appropriate and what review and termination provisions exist.

‘Chasing the dollar’ (or ‘following the dollar’) is a term used to describe an extension of mandate to overcome what may be seen as an inappropriate constraint on the powers of the auditor-general.

The term can simply mean allowing an auditor-general access to documents held by a grant recipient (or contractor to government) to assist in undertaking an audit (performance or financial) of the government agency concerned. It can also mean that the recipient organisation itself or the service(s) it provides become subject to audit.

The ‘access to records’ issue can be addressed by requiring government agencies to include an appropriately worded provision in all contracts and grant agreements, allowing access by the auditor-general. However it may be more efficient for it to be expressed consistently in legislation, to avoid the possibility of an accidental or deliberate omission in a contract.

The issue of an auditor-general having the power to audit a grant recipient’s performance is less straightforward. The need for such an audit presupposes the lack of an appropriate and effective accountability framework for the specific grant program(s). In my view that is a failing of government, not the private sector or not-for-profit entity involved, and auditor-generals already have substantial powers to review such failings by government agencies. I would suggest there needs to be strong arguments advanced as to why an auditor-general’s powers need to go beyond this.

4. THE OFFICE'S SELECTION OF PERFORMANCE AUDIT TOPICS

4.1 General Observations

Finding: The Office has a very well-established and robust process in place to guide the selection of a performance audit program.

Unlike the financial report audit function (which is generally required to be undertaken in respect of every government entity each year), auditors-general have finite capacity and funds to apply to the performance audit role each year. At the same time the breadth and complexity of government in modern society means that there is a vast array of potential activities whose performance could be audited.

Anyone (governments or oppositions, members of parliament, lobby groups, members of the public, audit office staff, etc) may suggest a topic. However in all Australian jurisdictions that have legislated to enable the auditor-general to undertake performance audits, the auditor-general is given full authority to choose audit topics²⁰.

Hence it is very important that auditors-general maximise the value they provides in carrying out this function, by selecting that mix of topics which will give the greatest 'return' for the funds employed. Most audit offices have developed structured processes for identifying potential topics and criteria for assessing their relative priority.

Part 2 of the Audit Office's *Performance Audit Methods and Practices* (PAMPr) Manual sets out the ACT Audit Office's approach in selecting a program of performance audits. (A diagrammatic representation of the process, taken from the PAMPr Manual, is shown on the following page.)

The Manual sets out the following 'framework' (ie overarching) policy:

"The Auditor-General, assisted by the Director, shall implement procedures to plan a performance audit program that:

- ensures appropriate audit coverage over time of significant aspects of ACT Government administration;
- achieves a reasonably balanced coverage across portfolios;
- responds to emerging risks, and issues of interest to the Legislative Assembly and the broader community, including environmental issues; and
- recognises the constraints of the Audit Office's resources."

Subsequent sections of Part 2 of PAMPr set out the following policies to be applied within that framework policy:

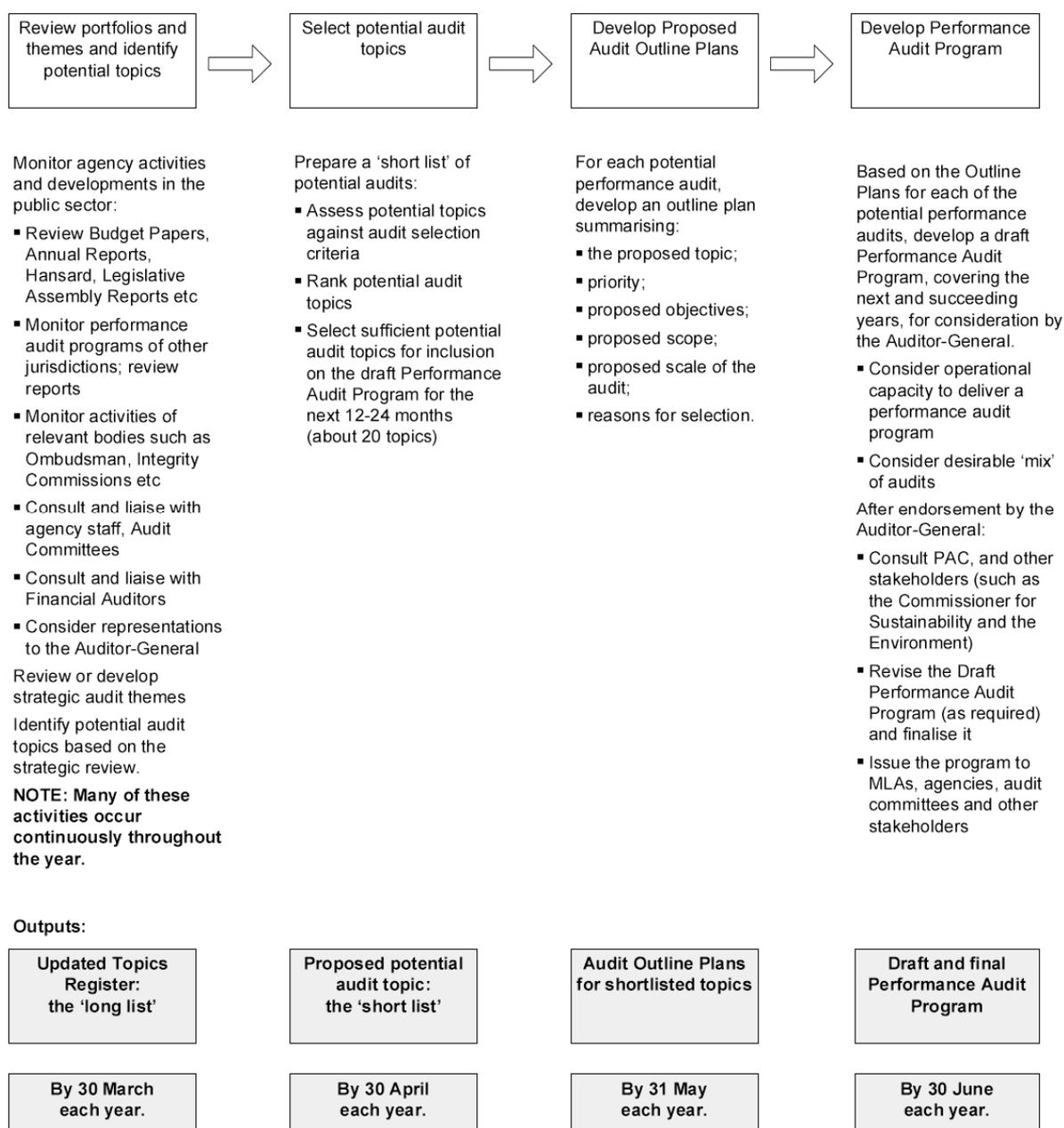
- reviewing portfolios and themes
- selecting potential audit topics
- developing audit outlines
- the proposed performance audit program.

²⁰ Very occasionally, legislation may be passed requiring an auditor-general to conduct a specific performance audit. In these limited cases, the legislation has usually provided for additional funding to the audit office so that its 'normal' performance audit program is not compromised.

Each of these sections also contains ‘practice statements’, ‘guidance’ and, where appropriate, ‘templates, references and examples’. These are designed to assist firstly, any member of the Audit Office staff to identify topics for inclusion in the *Performance Audit Topics Register* (the ‘long list’) and secondly, the Director, Performance Audit to select those topics for inclusion in the *Draft Performance Audit Program and Forward Program* (the ‘short list’) for the Auditor-General to consider.

The PAMPr material is comprehensive (totalling some 20 pages) and clear as to each staff member’s responsibilities. It details the current list of ‘themes’ to be taken into account (including themes such as ‘Governance and Accountability’, ‘Sustainability and the Environment’ and Procurement and Contracting’). It also provides a list of 19 possible ‘consider points’ that staff should take into account in suggesting possible topics.

Strategic planning – selecting a program of performance audits



From the 'long list' of potential topics, Audit Managers undertake a ranking exercise. This ranking uses the following 6 criteria set out in the Manual:

1. Significance
2. Environmental significance
3. Risk to good management
4. Potential audit impact
5. Previous reviews
6. Auditability.

The criteria are explained in further detail in the Manual.

Based on the rankings, the Director, Performance Audit then finalises the 'short list' for the Auditor-General to consider. From my experience, these criteria are broadly consistent with those generally used by audit offices in Australia in evaluating potential performance audit topics.

The PAMPr policy also provides that the Auditor-General will seek the views of the Territory's Public Accounts Committee on possible audit topics each year. It notes that it is expected the PAC will write to all standing committees seeking suggestions for audit topics.

One aspect of the topic selection process that I believe does warrant greater attention is cost estimation.

The estimated cost of each potential audit topic should be one of the factors that determines which are selected for inclusion in the Office's program. If these costs are not estimated with an appropriate degree of accuracy, less-than-optimal decisions may be made as to which topics are selected or omitted. (See also Section 3.3.3.3 *Controlling Costs and Time* for further discussion on cost variations on performance audits.)

While 'proposed scope' and 'proposed scale' are assessed for each topic being included on the 'short list', this does not extend to an estimation of audit costs. In my view, greater effort needs to be made at the selection phase in identifying the factors that will contribute to the ultimate cost of individual audits. Such factors might include:

- the breadth and degree of complexity of the subject matter of proposed audit
- the number of individual agencies or business units to be included in the audit
- the need for 'case studies' as part of the audit
- the number and mix of staff at different grades in the audit team
- the level of experience and understanding of the topic that audit staff possess
- the need for any external experts to advise or assist the team
- the number and location of site visits

- the likely extent of ‘push-back’ on possible audit findings and the degree of consultation with senior agency staff that will be needed to resolve contentious issues.

Once these factors are identified, a preliminary estimate of costs could be prepared. By definition, cost estimates made before an audit starts can never be fully accurate. However greater attention to cost estimation at this stage of the process would assist the Auditor-General in selecting the best program of audits to be undertaken.

Recommendation 14: In selecting its draft program of performance audits, the Office should ensure more rigorous estimating of the cost of each potential topic.

Audit Office Response: Agreed in principle. The Office will consider whether the recommended approach will provide any additional benefits to the current approach adopted by the Office.

Under the Office’s current practice, at the early stage of audit selection process, the Office identifies proposed audits as small, medium, or large, with each category allocated a nominal budget based on the Office’s experience with completed audits. This is sufficient for matching the proposed performance program to the Office’s performance audit capacity. All audits included in the proposed performance audit program are considered to represent a good match between the resources required and the potential benefits from the audit.

The resource estimation process becomes more refined as the understanding of the subject is developed. At the time that the Audit Work Plan is approved, the audit objectives, scope, and approach will be better defined, and resources required will also be better assessed. The initial budget approved with the Audit Work Plan for each audit is based on factors known at the planning stage.

4.2 Identifying Savings

Performance audits are usually defined as encompassing ‘economy, efficiency and effectiveness’²¹. These terms are themselves usually understood to mean the following:

- **economy** means minimising the cost of resources acquired or used, bearing in mind the quality
- **efficiency** covers the relationship between the output of goods or services and the resources used to produce them
- **effectiveness** covers the relationship between the intended and actual results of projects and programmes²².

One of the perennial issues facing auditors-general is the extent to which their performance audits should identify savings that can be achieved in the delivery of the services being audited. By this it is generally meant the extent to which performance audits should focus on economy and efficiency, as opposed to effectiveness.

21 See, for example s38B(1) of the NSW *Public Finance and Audit Act 1983*. Interestingly the ACT *Auditor-General Act 1996* defines a performance audit much more broadly, being “in relation to a person, body or thing, a review or examination of any aspect of the operations of the person, body or thing”.

22 Source: UK National Audit Office Annual Report.

With governments around the world facing increasing financial pressures, there is often an expectation by governments that auditors-general will contribute to budgetary management by identifying savings that can be made in existing government programs. The issue has received greater attention since the UK National Audit Office set itself the target of achieving a ‘financial impact’ of £9 for every £1 it costs to run the office. In its 2009 Annual Report, it stated that it had achieved a financial impact of £768 million in the preceding year.

The issue is by no means static. It was less than a decade ago that auditors-general in Australia were being criticised as being too focussed on efficiency at the expense of effectiveness²³.

The first observation I would make is that where auditors-general have a performance audit mandate, they are given (quite appropriately) complete freedom as to the topics they choose to pursue. That is not to say that governments or central agencies such as treasuries should not be able to suggest to auditors-general potential topics that have an economy or efficiency focus. But the choice of performance audit topics must always remain the sole responsibility of the auditor-general.

The second observation is that in my view auditors-general have tended to concentrate more on effectiveness (either through their choice of audit topics or through the focus that is placed on individual topics) because they see this as more aligned with what parliaments expect. Parliaments are representatives of the general population and are more interested in whether services are being provided in a way that meets the public’s needs. Executive governments may share that interest but are better placed to address questions of the efficiency with which their agencies operate. To put it another way, parliaments are more likely to be interested in whether ambulances arrive on time or emergency departments deal appropriately with patients, than whether the costs they incur are reasonable.

If this hypothesis is correct, it would be even more likely that an auditor-general with a relatively limited performance audit capacity would concentrate on audits with an effectiveness focus.

The third observation I would make is that the extent of ‘financial impact’ achieved through performance audits (in the sense the term is used by the UK National Audit Office) does not necessarily equate to efficiency gains that could translate to budget bottom-line savings. In 2008 around 40 per cent of the NAO’s £768 million ‘financial impact’ was through increased revenue collection (more about the effectiveness of the tax administration) rather than reducing the cost of tax collection activity (ie efficiency).

The fourth observation I would make is that I see no inherent or inappropriate bias in the ACT Audit Office against topics that might achieve savings. Recent topics such as *Maintenance of Public Housing*, *Government Office Accommodation*, *Collection of Fees and Fines* and *Credit Card Use, Hospitality and Sponsorship* all have elements that could result in savings through improved management practices.

23 Richard Mulgan “Auditors General: Cuckoos in the Managerialist Nest?” (2001) 60(2) Australian Journal of Public Administration pp24-34.

5. MANAGEMENT AND RESOURCES

5.1 Overall Management of the Office

Below the position of Auditor-General, the Office is essentially structured into three functions: Financial Audit; Performance Audit; and Corporate Services. Financial Audit and Performance Audit are each headed up by a Director, with the Director of Performance Audit also heading up the corporate services function. While staff below that level are largely allocated to one of the 3 functions, the Office adopts a degree of flexibility to assist in dealing with fluctuating workloads and its limited resources, particularly in corporate projects.

The Office is managed through a series of small committees.

The *Executive Committee*, consisting of the Auditor-General and the 2 Directors, meets weekly. It provides the Office's strategic direction, monitors the Office's overall performance and performance against the Strategic Plan, sets policy and determines operational priorities.

The *Management Committee* meets monthly. It consists of the members of the Executive Committee plus Managers (audit and corporate services). Its role is less strategic and more operational than the Executive Committee, but still operates at a relatively high level.

Beneath these committees, the management of each functional area meets fortnightly or as required to consider more detailed issues that require addressing.

The Office also has an *Internal Audit and Review Committee*, with an external, independent chair. The Committee meets each quarter. From my review of the minutes of the Committee's last 3 meetings and discussion with the chair, I was comfortable that it was taking an active role in identifying issues and risks that the Office should address and monitoring the Office's progress on those issues, interacting appropriately with the external and internal auditors, and monitoring the preparation of the Office's annual financial statements.

As part of the Review, I also verified the existence of policies and plans needed for the effective governance of the Office. These included the Risk Management Plan, Internal Audit Plan, Asset Management Policy and Business Continuity Plan. From a high level review of those documents, nothing came to my attention that gave any cause for concern.

5.2 The Office's Strategic Planning

The Office performs its role in the context of a 3-year Strategic Plan, currently covering the period 2008 to 2011, but which is reviewed annually. All staff are involved in the annual review and in the development of a new Plan each 3 years through an annual planning day that they attend. The Plan is published on the Office's website.

The current Plan indicates that the Office sees its vision as being “to enhance the performance and accountability of the ACT public sector”. In working towards that vision, the Office commits to the following values:

- independence
- integrity
- professionalism
- respect
- learning and innovation.

The 2008-2011 Plan sets out “Our New Direction” for the period in the areas of “capacity and services”, “people” and “working environment”. To achieve the new direction, the Plan identifies where the Office was in 2008, where it wants to be, and the processes it needs to put in place to get there.

The Plan indicates that it will assess its success against the two outcomes of “an accountable, effective and efficient ACT public sector” and “a highly valued ACT Audit Office”. Within each of those outcomes is a number of objectives and, below that, a series of strategies.

In my view, the Plan is clearly-written and the goals and directions it establishes are appropriate. It recognises the Office’s stakeholders and identifies how their needs will be met. Its “where we are now’ and “where we want to be” format presents openly the issues that need to be addressed and improved, providing a strong incentive for action.

Supporting the Strategic Plan is a more detailed annual Action Plan which assigns responsibilities for individual actions and their timing. The Office’s Executive Committee meets weekly and part of its role includes monitoring progress on the Action Plan deliverables.

For a small organisation, I believe that the approach taken by the Audit Office demonstrates a sound commitment to strategic planning.

5.3 Managing and Developing Staff

Finding: The Office takes an active approach to managing and developing its staff and is conscious of the need to address the issue of staff retention.

The high staff turnover experienced by the Office over recent years (as shown in the following table) has had a significant effect on its operations.

Audit Office Recruitment and Attrition, 2004-05 to 2008-09

Staff Movements	2004-05	2005-06	2006-07	2007-08	2008-09
Recruitment	7	10	17	10	8
Attrition	6	8	9	11	12
Number of staff	28	30	38	37	33
Turnover (%)	21.4	26.7	23.7	29.7	36.4

The Office also recognises that nearly a quarter of its staff are aged 53 or more and that this will contribute to continuing staff turnover in coming years as well as involving the loss of much experience and corporate knowledge.

The Office has tackled its staffing challenges through a number of mechanisms:

- a longer-term Workforce Planning Strategy which includes specific measures to retain key staff, succession planning and on-the-job development opportunities
- shorter-term measures such as use of contract staff where appropriate, better scheduling of staff resources over peak periods, and using staff on both performance and financial audits, and on corporate tasks.

The Office has also recently reviewed its approaches to learning and development, and to staff performance management. New policy and procedure documents were released in September 2009, consolidating and upgrading existing practices.

As part of the Review, I reviewed both policy documents. I also reviewed a range of associated documents such as:

- the approved L & D programs for 2008-09 and 2009-10
- quarterly L & D reports showing progress against the approved programs
- *pro forma* performance agreements between the Office and individual staff members
- *pro forma* performance appraisal forms.

Both the L & D and performance management policy documents are integrated with whole-of-government legislation and policies and with the Office's Collective Agreement with staff. They are concise, well set out, clearly-expressed and make rights and responsibilities clear. In addition they cover issues such as privacy and natural justice in an appropriate manner.

As with other new policies and practices developed in response to the APES 320 requirements, the challenge now for the Office is to ensure that they are fully applied.

5.4 Setting Financial Audit Fees

The Office currently sets its overall financial audit fees each year with the intention of recovering the costs of its financial audit activity. In doing so, it has excluded any share of the cost of office-wide projects, such as the recent APES 320 compliance project. The Office's view, as I understand it, is that such Office-wide projects should be funded from the annual appropriation for the Office's net cost of services (or a specific addition to that appropriation).

The Office maintains, correctly, that there is no legislative requirement as to how the appropriation can, or cannot, be used. Nor does section 16 of the *Auditor-General Act 1996* require the Audit Office to set its financial audit fees to recover the full cost of financial audit.

However the general understanding among stakeholders is that the appropriation is intended to support activities other than financial audit. These activities would include performance auditing, dealing with public interest disclosures, supporting the work of the Legislative Assembly and its committees, etc.

If a private sector accounting firm implemented a new 'whole of practice' time management, HR or quality assurance system, each part of the practice (eg audit, taxation, consulting) would be expected to cover an appropriate share of the system's costs. This would normally be achieved by increasing the hourly 'charge rate' applying to each level of staff.

In my view, if the Audit Office is unable to attract an increase in the appropriation to cover the cost of Office-wide systems, it would be more appropriate for each aspect of the Office to bear its own share. That is, financial audit fees should be set to cover the financial audit share of the costs and the Office's other activities should meet their share from the appropriation.

In making this recommendation, I acknowledge that at the end of the year, financial audit fees will never exactly match financial audit costs. I have no issue with any deficit being met from cash reserves (or the appropriation) or any surplus being used to build up cash reserves. My issue is simply with any *ex ante* decision to not balance full financial audit costs with fees.

Recommendation 15: The Office should set its financial audit fees with the aim of recovering an appropriate share of the costs of office-wide projects and systems such as quality control (unless it receives additional appropriation to cover those costs). Financial audit costs should not be budgeted to require support from the existing appropriation or from cash reserves.

Audit Office Response: Agreed, subject to a further consideration of the benefits and costs of the recommended approach. The Office's practice has been to seek additional appropriation funding to meet the costs of significant whole-of-office projects because this approach is more transparent than including a levy in the audit fees charged to each agency for their 'fair share' of such costs. The Office notes that actioning this recommendation may result in an increase in audit fees.

5.5 Diseconomies of Small Size

Finding: The ACT Audit Office's relatively small size does not appear to have impacted significantly on its cost structure or the quality of services it provides. Based on the evidence available, it appears to achieve high productivity from its staff.

In carrying out this Review, I was very conscious of the relatively small size of the ACT Audit Office. While most criteria for judging performance might be unrelated to size (and some, such as adherence to auditing and professional standards, are absolute), I was careful not to impose the perspective of a much larger audit office in suggesting solutions to problems identified.

However I did consider that it would be useful to explore the issue of the small size of the Office in considering some key criteria such as costs of operations.

The ACT Office is one of the smaller audit offices in Australia, with a total staff of approximately 31 (EFT basis) as at 30 June 2009. This compares to total staffing at the same date of 41 in the Tasmanian Audit Office, but 249 in the New South Wales Office and 149 in the Victorian Office. (The Northern Territory Audit Office has only around 4 staff, but operates under a completely different model with almost all audit work contracted out to private sector providers.)

A relatively small size can bring both advantages and disadvantages to an organisation. Advantages include shorter lines of communication between staff, the ability to respond more quickly to issues and (potentially) higher levels of staff identification with the organisation's corporate objectives.

However economic theory suggests that the disadvantages of small scale would pose challenges. There are a number of functions in any audit practice that must be undertaken regardless of (or with limited relationship to) the size of the practice. These would include the position of Auditor-General itself, maintenance of basic IT and other systems, preparation of corporate publications such as annual reports and policy/procedure manuals, basic HR and finance functions, etc.

A flexible approach as to how these functions are performed can overcome the disadvantages of small scale to some extent, but cannot eliminate them entirely. To the extent that they cannot be eliminated, the result must (economic theory suggests) be reflected in higher unit costs or lesser quality of services.

One measure of the impact of these 'fixed' costs on the ACT Audit Office can be judged from the ACAG Macro Benchmarking Survey table *Percentage of total (whole-of-office) paid hours charged to audit activities*. A lower figure for the ACT would suggest that these fixed activities (at least to the extent that they are 'corporate' and not a part of 'audit') absorb a higher proportion of staff time.

However the ACT figures for the 4 years from 2005-06 to 2008-09 (inclusive) varied between 59 and 62 per cent, while the (simple) average figures of all states and territories (ie excluding the Australian National Audit Office) were much *lower*, varying between 49 and 51 per cent. In fact in most years, the ACT Audit Office was able to record the highest percentages of all jurisdictions.

To some extent the ACT figures are 'skewed' upwards as IT functions are largely outsourced to InTACT²⁴, rather than being provided by in-house staff as in most (but not all) other audit offices. However I do not consider that this explains away the difference.

Without an in-depth analysis of all audit offices' expenditures on what may be considered 'fixed' costs (clearly beyond the scope of this Review), it is not possible to be more definitive on the impact such costs have on overall costs. Regardless, based on the relatively unsophisticated analysis allowed by the available data, it is apparent that the ACT Audit Office has been able to operate in a way that achieves high productivity of its staff, despite the small size of its operations.

24 InTACT is a Shared Services business unit within the ACT Department of Territory and Municipal Services.

5.6 The Office's Funding

Finding: Notwithstanding the small population of the ACT, the Territory Government delivers much the same range of services as the larger State governments. To provide the ACT Legislative Assembly with a comparable level of assurance as to the efficiency and effectiveness of those services, there is a need for a broadly comparable performance audit program in the ACT.

The Terms of Reference for this Review require me to “assess the adequacy of the Office's human, financial and equipment resource and resource management practices”.

I found no evidence that the Office's “equipment resources” (which I have interpreted to cover both hardware and software) were in any way inadequate. Office staff seem to have available to them a level of equipment that I would expect in a modern audit practice.

The Office has basically two sources of funding.

Under section 16 of the *Auditor-General Act 1996*, the Office may recover the costs of its financial audits by charging fees to client agencies. These fees totalled some \$3.2 million in 2008-09 (but around \$3.3 million on a cash basis). Clearly then the Office is generally not constrained in raising what it sees as the appropriate level of revenue to meet the costs of its financial audit role. (I note however that in respect of fees charged for audits of ‘Territory-owned corporations’, the Treasurer's approval is required if they cannot be agreed between the Office and the entity.)

Apart from a relatively minor amount of interest earned on cash balances, the only other source of funds for the Office is the annual appropriation from the Consolidated Fund. This amounted to \$2,072,000 in 2008-09.

Under the Territory's budgeting system, this appropriation is described as a “Government payment for outputs” and, under section 9 of the *Financial Management Act 1996*, is deemed to be made for the “net cost of providing the outputs” of the agency.

The Office applies the appropriation towards the net cost of its overall operations, but aims to cover the costs of its financial audit work through the fees it sets. (See also Section 5.4 which discusses the treatment of costs associated with Office-wide projects.)

These other services include:

- performance audits and reports
- dealing with disclosures under the *Public Interest Disclosure Act 1994*
- preparation and printing of the Office's report to the Legislative Assembly on its annual financial audits
- liaising with the Assembly and its committees, including preparation of submissions and appearing at hearings

Effectively then, the appropriation is used by the Office to cover the costs of services other than financial audit. However the appropriation is often perceived by stakeholders as being solely for ‘performance audits’ when there are other services it also funds. This lack of understanding by stakeholders may contribute to a lack of appreciation of the funding that the Office has available to apply to its performance audit role.

The Office does not currently compile data showing the individual cost of each of the various services funded by the appropriation. This would be a worthwhile exercise as it would clarify the extent of resources it has available to support its performance audit role.

Recommendation 16: The Office should compile and publish in its Annual Report, information on the cost of activities charged to the appropriation, including performance audit, protected disclosures, services to Legislative Assembly committees, etc.

Audit Office Response: Agreed in part. The Office will consult further with the Public Accounts Committee on whether there is a need for such information.

The Audit Office already regularly and clearly reports to the Legislative Assembly on the services delivered with the appropriation funds such as delivering the performance audit program, providing various reports to the Assembly; conducting investigations associated with public representations, examining public interest disclosure matters, and providing advice and services to Legislative Assembly Committees.

Given the Audit Office’s small appropriation, it would not be efficient to compile additional cost information for external reporting for each of the services or products delivered, in addition to the comprehensive information the Office already provides in its annual reports and to various legislative committees.

The issue currently receiving attention in the Territory is the ‘right’ level of annual funding to support the Audit Office’s performance audit program (or more correctly, the services for which it cannot charge fees).

The short answer is that there is no ‘right’ level.

Most auditors-general would argue that the range and complexity of government services continues to grow, that the community increasingly expects not only that government services are efficient and effective, but that this is demonstrated to be the case, and that their current funding is inadequate.

The difficulty for a smaller jurisdiction such as the Territory is that it provides virtually the same range of services as a State such as New South Wales, certainly to a smaller scale, but nevertheless of a similar breadth. But to fund the same level of assurance via an independent performance audit function will clearly cost more in per capita terms in a smaller jurisdiction. Is there any less need for informing parliamentary representatives and the public about the performance of the ACT Ambulance Service (say) than the NSW Ambulance Service?

If *equal per capita* funding is inappropriate (based on the NSW funding level, it would imply less than 1½ performance audit staff in the ACT Office), is *equal dollar* funding ‘right’?

Broadly equal dollar funding would allow for a performance audit program in the ACT broadly comparable to that in New South Wales (but there is no particular reason New South Wales should be the benchmark).

In my view the existing performance audit function is viable, but just so.

A program of 8 performance audits per year may seem reasonable, but allowance must be made within this for 1 or 2 'follow up' audits each year and probably at least one *ad hoc* request by the Public Accounts Committee, the Legislative Assembly or the Government.

The size of the program provided by the current funding level makes it difficult for the Office to plan a series of successive audits on a particular theme (such as environmental protection, governance, risk management). In turn this limits the opportunity for any real degree of specialisation by those employed in the Office, which would allow skills and knowledge from one audit to be transferred to the next. The small complement of performance audit staff also means that the impact of staff turnover (even if at a more normal level than recently) will have significant consequences.

It is an inevitable consequence of the small size of the Territory's population and tax base that some services will cost substantially more in per capita terms than in the larger states. How much the people of the Territory should pay towards the Audit Office's performance audit program is a decision that its elected representatives must judge.

6. RELATIONSHIP/COMMUNICATION WITH STAKEHOLDERS

6.1 Relationship and Communication with Parliament

6.1.1 The Relationship in General

Auditors-general have a special relationship with Parliament in democratic societies. They are independent of executive government and their role is very much in line with the responsibility of parliament to hold the executive accountable for the powers given to it, and the funding appropriated to it.

My main purpose in meeting with a sample of Members of the Legislative Assembly was to get their views as Members (ie on how the Audit Office's services and reports helped them in their parliamentary role), rather than as Ministers or shadow ministers. The reason for this is that I wanted to get an overall view of the performance of the Auditor-General and the Audit Office, rather than a view that had perhaps been influenced by a particular report on a particular portfolio. However the small number of Members in the Territory's Legislative Assembly means that most have ministerial or shadow ministerial responsibilities.

All Members that I met or spoke with shared a strong view that the role of the Auditor-General was a critical part of the accountability process of government. They all commented positively on the dedication of the Auditor-General and her staff and the independence they displayed.

Most Members spoke positively about the audit topics that had been selected and the reports released. However I was not surprised that some had concerns with certain matters that the Auditor-General had investigated and reported on recently, particularly matters that had enjoyed a high media or political profile. I was also not surprised that some held strong views as to the appropriateness of the Auditor-General investigating these matters.

It would be naive to suggest that an auditor-general could undertake the role without occasionally upsetting ministers or senior bureaucrats. The general population would be legitimately suspicious if that that never happened. Auditors-general must act 'without fear or favour'.

One recommendation of the last Review that has not been implemented was that the Office should undertake regular surveys to obtain of Members' views of the Office's performance. At the time, the Office was conducting triennial surveys and the recommendation was to move to annual surveys.

Subsequently, the practice of conducting surveys was stopped, and I was advised the last survey was held in 2003. It is understood that response rates from Members was too low to provide meaningful results. I note that the Office's current Strategic Plan notes an intention to conduct annual surveys, but I understand this has not happened.

Over the last 5 or 6 years, a number of audit offices in Australia have chosen to use substantially the same survey instrument, so that Members' views of their respective performance can be benchmarked.

Given the importance of the relationship between parliaments and auditors-generals, I believe the ACT Audit Office should get regular, structured feedback from Members.

Recommendation 17: The Office should implement a regular MLA opinion survey to obtain more formal feedback on its performance and should consider adopting the common survey instrument used by most other Australian audit offices.

Audit Office Response: Agreed. The Audit Office will seek formal feedback from MLAs on the performance of the Office.

The Office notes that given the small size of the ACT Legislative Assembly, it has reasonable contact with many MLAs and has frequent contact with the Public Accounts Committee. These contacts, as well as the regular monitoring of Assembly discussions and debates on the Office's operations in the Assembly, have provided good feedback on the performance of the Office. Nevertheless, the Office accepts that obtaining formal feedback through a survey may further assist the Office in monitoring its performance.

6.1.2 The Office's Financial and Performance Audit Reports to Parliament

Finding: The Auditor-General's various reports are well-written and effective in informing Members of the Legislative Assembly and other readers of matters that are relevant to them in meeting their roles and responsibilities.

The Auditor-General presents a range of reports to the Legislative Assembly over the course of each year. These include:

- a report setting out the results of the audits of the annual financial statements of government departments and business undertakings, and the Territory's consolidated whole-of-government report;
- reports setting out the results of performance audits undertaken by the Office; and
- the annual report of the Audit Office.

Unlike their counterparts in the private sector, auditors-general have extensive reporting obligations and powers that go beyond the one or two page 'independent audit report' issued in respect of each set of annual financial statements audited. These reporting obligations and powers are set out in broad terms in the enabling legislation of each auditor-general.

An auditor-general's report is primarily intended to be read by members of parliament, as it is parliament that holds the executive government to account for the way in which it has used public resources appropriated to it and administered laws passed by parliament. In reporting to parliament, the auditor-general provides a range of professional, independent information that helps parliament assess the performance of executive government.

However most members of parliament are not versed in technical accounting or auditing matters, nor are they necessarily experts on every subject matter that is reported on (ie the numerous activities of government agencies). Hence it is important that reports are expressed as far as possible in non-technical terms, even when they are addressing an important technical accounting or audit matter, or an issue relating to a specialised service being delivered.

An auditor-general's report may expose weaknesses in the operations of a government agency (or potentially a minister or the government), beyond strict accounting matters. Because each report becomes a public document after it is tabled, such weaknesses are often reported by the media, whose representatives may also have limited knowledge of the subject matter.

For these reasons, it is imperative that auditor-general's reports are well-balanced and clear as to the message they are conveying, so any risk of misinterpretation is minimised.

As part of the Review, I examined a number of reports presented to the Legislative Assembly by the ACT Auditor-General over the last two years. These reports included those where the audit process had been looked at as part of this Review, but also included a sample of other reports.

In my view, the Office's reports were well-written. In all types of reports, the language used was simple and technical jargon was generally avoided where possible. The use of graphs, case studies, diagrams and highlighting was appropriate in helping to convey information to the reader.

Valuable features in the annual *Financial Audits Report* (eg report no. 8 of 2009) included the overview of audit findings (Section 3 in the 2008-09 report) discussing issues such as:

- the quality and timeliness of agency financial reports
- the usefulness and meaningfulness of agencies' performance measures
- the timeliness of completing annual reports
- agencies' compliance with their budgets.

Further the inclusion of tables showing the status of audit findings, both in aggregate and for each agency, was also useful in conveying the auditor's view of the strength of agencies' financial management systems and agencies' preparedness to address issues identified in the audit.

Performance audit reports are inevitably longer and more complex than the coverage given to an individual agency's financial audit results. Because of the sensitivity that may attach to performance audit reports, it is vital that they be comprehensible to readers who often may have no deep understanding of the activities being reviewed or the issues being discussed.

In my opinion, the Office's performance audit reports satisfy all reasonable criteria for good reporting. They were well-structured and the layout and language used made for easy reading. Findings and recommendations were clearly expressed, as was the rationale for each audit having been undertaken. Executive Summaries were accurate and concise and the consolidated list of recommendations in each report would be useful for the reader who was not able to read the whole report. The discussions I had with Members of the Assembly were generally complimentary as to the quality of the reports.

The other dimension to reporting is timeliness.

Performance audit reports are the natural end product of the performance audit process, but the financial audit process is geared to the issue of the independent audit opinions to the audit clients. However it is generally accepted practice for auditors-general to submit a report to parliament on the results of their financial audit work, and in many jurisdictions this is mandated.

While the ACT has very tight deadlines for the submission of agencies' annual reports (and hence even tighter deadlines for the issue of the audit opinions), the Audit Office's report to the Legislative Assembly on the results of its financial audits is not tabled until mid to late December. In my view this is too late and the Office should aim for an earlier tabling, although I am conscious of the additional pressure this will place on the Office's staff.

The Office's practice of issuing a single report does allow it to report on a more holistic basis, but it also means that any issues in respect of agencies with a 31 December balance date (such as the University of Canberra) are not reported to the Assembly until nearly 12 months after year-end.

Recommendation 18: The Office should consider options for earlier submission of its report on the annual financial audits, including the option of issuing a supplementary report if the main report would otherwise be delayed by a small number of outstanding audits.

Audit Office Response: Agreed in principle.

The Audit Office has previously considered options for the earlier submission of this report and has concluded that to do so may compromise the quality of the report or incur additional costs, as well as leading to delays in other critical tasks performed following the completion of the financial audit program.

The summary report includes a significant component dealing with the audit of the whole-of-government financial statements. The outcome of this audit is not available until mid to late November. An earlier report to the Legislative Assembly (ie before December) would be much less useful as it would not include the Office's review of the whole-of-government financial report.

To date the matters raised in the report have not been time critical and the Audit Office would provide a report to the Legislative Assembly on any matter that it believes warrants earlier reporting. Also, any audit findings or recommendations that require urgent attention will have been brought to the attention of agencies in audit management reports which have also been provided to the relevant Minister.

Recommendation 19: The Office should consider reporting separately to the Assembly on the results of its audits of agencies with a 31 December balance date.

Audit Office Response: Not supported.

The Audit Office does not consider there is sufficient value in preparing a separate report for only a few agencies with a 31 December balance date. Should there be significant matters identified in the December audits that require the early attention of the Legislative Assembly, the Office can take appropriate action to report these matters to the Assembly.

6.2 Relationship with Audit Clients

Finding: Audit clients (both financial and performance audit) were generally very supportive of the way the Office interacted with them, although some felt that the level of its expertise had fallen in recent years, possibly because of staff turnover.

Audit Office Response: The Audit Office agrees that staff turnover has adversely affected the progress of some audits and other projects. The Office accepts that staff turnover may have contributed to a reduction in the level of experience of auditors, and has adapted its management and quality processes to address the risks this may create.

The independent reviewer concluded that the Office has performed its financial and performance audit functions well, and in particular that the performance audits selected for review were conducted with appropriate documentation, and audit findings and conclusions were soundly based.

As part of the Review, I selected a small sample of the Office's audit clients and met with their chief executives and other senior staff. The purpose of the interviews was to give stakeholders a relatively unstructured opportunity to convey their views about the fundamental strengths and weaknesses of the Office. Those interviewed were advised that their comments may be referred in my report, but would not be attributed to individuals.

The chief executives I interviewed were generally complementary about the Office.

Almost unanimously they indicated that they had few if any issues with the way the Office undertook its financial audit work. Some commented on staff changes and the difficulties this sometimes created for their own finance teams but staff changes were generally seen as more of an issue with performance audit. Some believed that the level of experience and expertise in this area of the Office's operations had declined over recent years. While they understood how this might have occurred, they were nevertheless concerned as to how it might affect any future performance audit in their area. However a number of them mentioned the willingness of the Auditor-General and her senior staff to discuss any issues as they arose.

Financial and performance audit clients are surveyed annually as to their views on the Office's performance. The two most critical measures from these surveys are reported as part of the Office's Statement of Financial Performance, with the results from recent years as follows:

Client Satisfaction Ratings, 2006-07 to 2008-09
(percentages of total responses)

Rating	Performance Audit Reports			Financial Audit		
	2006-07	2007-08	2008-09	2006-07	2007-08	2008-09
Very good	13	10	25	23	23	43
Good	45	50	50	45	50	45
Satisfactory	29	30	25	28	25	12
Poor	13	10	...	4	2	...
Very poor

Notwithstanding the concerns expressed to me by a number of client agencies, the performance audit ratings (at least in terms of satisfaction with the final report), have shown an improvement over the period. For both performance and financial audits, no negative (ie 'poor' or 'very poor') ratings were recorded in 2008-09.

6.3 Relationship with Staff

Finding: The Office's annual staff surveys show very high levels of staff satisfaction, despite the impact of continuing staff shortages in some areas.

Excluding the Northern Territory Audit Office (which contracts out almost its entire audit activity), the ACT Audit Office has the smallest staff complement of any of the Australian audit offices, with some 31 staff on an EFT basis at 30 June 2009.

Staffing issues may impose greater risks in a small organisation - a greater dependence on a few key people, an exposure to risk through staff absences, difficulties in retaining qualified staff, etc.

The Office has been conducting a comprehensive annual staff survey since 2004. Staff are strongly encouraged to respond and response rates are high (typically at least 85 per cent).

The annual survey is detailed, with 26 questions in the latest survey, comprising a mix of those requiring an 'agree/disagree' type of response and those seeking open-ended comments. Issue covered included: career opportunities; adequacy of work resources; work/life balance; workplace conditions, harassment and safety; management leadership, vision and direction; ethics in the Office; diversity and discrimination; and Office strengths and measures to improve its performance.

While the format of the survey and the wording of a number of the questions have changed over that period, the one 'key' question that has remained constant relates to staff members' overall satisfaction with their jobs. The results for that question from the last 4 surveys are as follows:

**Staff Survey Responses to Statement: ‘Overall, I am satisfied with my job’
(percentages)**

Response	2007	2008	2009	2010
Strongly agree	24	19	32	24
Agree	60	75	65	66
Neither agree nor disagree	8	3	3	3
Disagree	8	3	0	7
Strongly disagree	0	0	0	0
Total	100	100	100	100

The table shows that results for the individual response categories have fluctuated over the years, but this is partly due to the relatively small numbers of respondents. Notably, the lowest positive response (ie combining ‘agree’ and ‘strongly agree’) was 84 per cent which is a very strong result.

The Office devotes a significant level of resources each year to reporting back to staff on the results of the survey, identifying common issues raised and developing management actions where appropriate. Progress on management actions is reported back to staff. Key results from the survey and management actions are also covered in the Office’s Annual Report.

The Office has recently released the 2010 staff survey results to staff and the management’s response and planned actions are scheduled to be discussed at a staff meeting in May 2010.

While the surveys for the last 3 years have been conducted using an external web-based survey provider (‘SurveyMonkey’), a small number of staff expressed a concern to me about the anonymity of the responses. While management assured me that responses cannot be traced back to individual email addresses, the perception nevertheless exists and needs to be addressed.

7. ACCOUNTABILITY AND BENCHMARKING

7.1 Reporting on Performance

Finding: The Office takes its accountability to stakeholders seriously and is open in reporting on its performance, but there is scope for further improvement.

By the independent nature of their positions, auditors-general have limited obligations to report on the performance of themselves and their offices. Nevertheless there has been a strong recognition by auditors-general in Australia that they should ‘practice what they preach’ in terms of being accountable for the way they have used taxpayers’ money in discharging their duties.

One of the principal ways in which this accountability is met is through the publication of an annual report.

In my view, the Office’s latest annual report (ie for 2008-09) also satisfies what I believe to be the main criteria for an effective annual report. It:

- was released on a timely basis (29 September)
- is well-structured and laid out, with key information summarised for easy reference
- is comprehensive in describing the Office’s roles, responsibilities and activities during the year
- provides information to assist the reader in assessing its performance (against targets where applicable) and
- is written in a plain English style to ensure that the content is understood.

As indicated elsewhere in this Report, the ACT Audit Office is a party in the annual co-operative collection of performance data by all audit offices in Australia (the Australasian Council of Auditors-General *Macro Benchmarking Survey*). Key data available from this collection covers measures such as audit costs, timeliness of audit activity and reporting, and staff utilisation.

While the ACT Audit Office has used the data from this collection for internal management purposes, it has made little use of it in discussing its performance in its Annual Report.

In part this may reflect the requirement in the ACT for general government sector agencies²⁵ to publish a range of agreed KPIs in a Statement of Performance that is included in their annual reports. These KPIs have a strong focus on the year under review, whereas the multi-jurisdictional information from the *Macro Benchmarking Survey* is usually not available until well after the ACT Audit Office’s Annual Report is tabled.

I also recognise that, as one of the smallest audit offices, statistical averages may not always be a useful indicator of relative performance.

25 As opposed to government businesses.

Despite this, the advantage of the ACAG benchmark exercise is that it provides an opportunity for member offices to compare their performance with their 'peers', not only with their own performance of the previous year or any targets they had set for the year under review. A number of other audit offices in Australia currently publish such data in their annual reports, albeit lagged a year. Where appropriate, explanations are also provided to assist the reader to put the statistical results in context.

Recommendation 20: The Office should consider making more use of the ACAG benchmarking survey data in reporting on its performance in its annual report.

Audit Office Response: Agreed. The Audit Office will consider the use of the ACAG benchmarking survey data in the reporting of its performance in its annual report.

The Audit Office has not previously included such information in its annual report because of the inherent limitations in benchmarking studies, such as the differences in the mandates of Auditors-General across Australia and different cost structures, and the one year lag in comparative data. Nevertheless, consideration will be given to using benchmark data where such use can provide meaningful insights into the performance of the Audit Office, and is consistent with the undertaking among ACAG members regarding the confidentiality and use of the survey data.

7.2 Benchmarking

7.2.1 Timeliness of Financial Audit Completions

Finding: The Office has one of the best records of all state and territory audit offices for completing its financial report audits in a timely manner. Where it has not completed an audit according to its own timing benchmarks, this has largely been due to the agency concerned being late in submitting its financial report.

The Office's 2008-2011 Strategic Plan set a target of issuing 95 per cent of financial report audit opinions within the "required timeframe". For this purpose, the required timeframe is that set out in legislation, in timetables issued by the ACT Treasury, or as agreed between the Audit Office and the agency concerned. This target is one of those reported on in the Office's Statement of Performance and included in its Annual Report.

The 2007-08 and 2008-09 Annual Reports show actual results achieved of 100% and 93% respectively²⁶. The 2008-09 Annual Report notes that the five audits not completed on time were "because the financial reports were not provided to the Audit Office within the agreed timeframe".

The ACT Office's own reporting is reinforced by data available from the 2007-08 and 2008-09 ACAG *Macro Benchmarking Surveys* which show the following comparisons:

26 Both the 2007-08 and 2008-09 Annual Reports show a target of 100% rather than the 95% set out in the Strategic Plan. The actual results have been reviewed by the Office's external auditor.

Timeliness in Issuing Financial Audit Opinions

Time from Agency Balance Date to Audit Completion	2007-08		2008-09	
	ACT	Average, all States and Territories	ACT	Average, all States and Territories
<2 months	24%	9%	23%	12%
2-4 months	77%	68%	72%	62%
4+ months	0%	23%	5%	26%

Source: ACAG Macro Benchmarking Survey

Note: Percentages may not add to 100 due to rounding

While the data in the table suggest that the Office’s performance fell slightly in 2008-09, it was still substantially better than the average for all state and territory audit offices. This was particularly the case for opinions issued more than 4 months after balance date, with the ACT Audit Office having only 5 per cent of audits in this category, compared to the average of 26 per cent.

An alternative ACAG measure of timeliness, for which a longer time series is available, is the proportion of audit opinions issued within 3 months of the balance date of the audited agency. As shown in the following table, this measure not only confirms the above observation, but shows that the ACT Audit Office consistently ranks first or second in timeliness.

Proportion of Financial Audit Opinions Issued within 3 Months

Year	ACT	Average, all States and Territories	ACT Ranking (of 8 Audit Offices)
2005-06	86%	47%	1
2006-07	84%	42%	2
2007-08	89%	51%	1
2008-09	88%	52%	2

Source: ACAG Macro Benchmarking Survey

7.2.2 Cost of Financial Audit Opinions

The ACAG Macro Benchmarking Survey provides estimates of the average cost per financial audit opinion issued in each audit office. A comparison between the ACT average for each of the last 3 years and the average for all state and territory audit offices is shown in the following table.

Average Cost per Financial Audit Opinion (a)

2006-07		2007-08		2008-09	
ACT	Average, all States and Territories	ACT	Average, all States and Territories	ACT	Average, all States and Territories
\$45,431	\$47,893	\$65,380	\$52,530	\$56,892	\$53,619

(a) Excluding local government opinions.

Source: ACAG Macro Benchmarking Survey

Because of the volatility of the figures, the comparison is inconclusive as to the relative cost structure of the ACT Audit Office's financial audit activities. However the Office believes that its figures shown are accurate.

There are many factors that might cause the average cost of a financial audit opinion in the ACT to differ from the average across Australia:

- the smaller scale of the ACT public sector in general would suggest that the cost per audit might be lower
- but perhaps offsetting this is the fact that the ACT has fewer agencies than some other jurisdictions, ie each agency has a broader range of functions
- as the two main determinants of audit costs are the number of audit hours and the average hourly fee, the ACT might be expected to have lower costs per audit as its 'cost per audit hour' is below the average of all states and territories
- the shorter timeframes for audit and reporting in the ACT compared with some other jurisdictions may impose additional costs
- some audit offices (including the ACT Audit Office) issue an audit opinion on Statements of Performance or their equivalent and it is not clear how this may be dealt with in the ACAG cost data.

Given the apparent volatility of the ACAG data for this measure, it was not possible for this Review to make any finding on the relative costs of the ACT Audit Office's financial audit function. However as this is the major area of cost in the Office, the Office should attempt to investigate the consistency of the data with other participating audit offices to see if it can be made more useful.

Recommendation 21: The Office should attempt to clarify the basis of the ACAG data on costs per financial audit opinion with a view to benchmarking its own costs.

Audit Office Response: Noted.

All measures in the ACAG Benchmark Survey are defined, including the inputs to the measures, in an attempt to ensure consistency in interpretation across participants. All Audit Offices have contributed to the ongoing refinement of the survey, and have tried to address as far as possible some issues on data inconsistency.

The issues raised by the independent reviewer reflect the inherent and practical limitations of benchmarking data, and further effort and resources by the Office to investigate the data provided by other Audit Offices is unlikely to result in any additional benefits to the Office.

7.2.3 Timeliness and Cost of Performance Audits

Finding: Despite the difficulties associated with high levels of staff turnover, the Office has a consistently good record in completing its performance audits in a short timeframe and at an average cost significantly below other jurisdictions.

Section 3.3.3.3 commented on cost increases and delays with some of the Office's performance audits over the last 3 years. Nevertheless the ACT Audit Office shows up well in comparisons of 'elapsed times' between the start of an audit and the tabling of its report. The following table shows that the Office consistently rated in the top half for duration of audit (of those audit offices that had a performance audit or performance management system audit role).

Average Time Taken for Performance Audits (months)

Year	ACT	Average, all States and Territories	ACT Ranking (of 6 Audit Offices) (a)
2005-06	8.1	8.3	2
2006-07	5.5	10.1	1
2007-08	6.8	8.5	3
2008-09	7.1	9.6	2

(a) 1 = shortest time

Source: ACAG Macro Benchmarking Survey

Similarly, while there have been significant fluctuations in the ACT Audit Office's average cost per performance over recent years, the ACT's average cost has been consistently well below the average of all state and territory audit offices.

Average Cost per Performance Audit (\$)

Year	ACT	Average, all States and Territories	ACT Ranking (of 6 Audit Offices) (a)
2005-06	\$180,067	\$237,457	2
2006-07	\$160,418	\$230,879	2
2007-08	\$220,478	\$260,493	2
2008-09	\$184,999	\$287,866	2

(a) 1 = lowest cost

Source: ACAG Macro Benchmarking Survey

8. RECOMMENDATIONS OF THE PREVIOUS INDEPENDENT REVIEW

Finding: The Office has implemented the substantial majority of recommendations it accepted from the 1998-99 Review, with most deviations satisfactorily explained.

The last review of the ACT Audit Office under the provisions of the *Auditor-General Act 1996* was conducted in 1998-99. The terms of reference for this current Review require me to:

Assess and evaluate how well the recommendations of the 1998-99 independent performance audit of the operations of the ACT Auditor-General and ACT Audit Office have been actioned, and in particular, determine the extent to which they have been implemented and whether they are achieving their desired objectives.

The August 1999 report of that review, undertaken by Audit Victoria (the formerly separate, commercialised arm of the Victorian Auditor-General's Office) found that the ACT Audit Office:

“is operating economically, efficiently and effectively. However, in forming this conclusion, we believe that scope exists for the Office to improve its performance further enhancing its effectiveness”.

The report made 44 recommendations. Those recommendations were reproduced in the Office's 1998-99 and 1999-2000 annual reports, together with the Office's responses to the recommendations and progress made in implementing those recommendations that it had accepted. In 2000-01 the Office included a section detailing those recommendations that had been implemented during the year, with the only recommendations not then implemented being those that the Office had not accepted.

According to the Office's 2000-01 Annual Report, the status of the review's recommendations as at 30 June 2001 was:

Implemented	28
Implementation outside the Office's control	2
Not accepted	14
Total	44

As part of this Review, I requested the Office to provide me with a schedule showing all the recommendations from the 1998-99 review, the Office's response at the time, and the current status of any actions that had been taken to address the recommendations.

From my examination of this schedule and the identified actions, I am satisfied that the Office has substantially addressed each of the previous review's recommendations. Given the passage of time, it is not surprising that some of the actions taken to implement the recommendations have themselves subsequently been superseded by newer policies and processes (eg in relation to quality control).

I am also satisfied that the reasons given by the Office at the time for not accepting certain recommendations were generally valid. However there were 3 recommendations that I believe warrant further consideration by the Office given the findings of this current Review:

- the introduction of regular surveys of MPs' views of the Office's performance
- the need to review financial audit fee-setting
- the inclusion of pertinent data from the ACAG benchmarking exercise in the Office's annual reports.

These issues are discussed elsewhere in this Report.

Appendix 1: Terms of Reference

The terms of reference for the Review were as follows:

Objective

The objective of an independent performance audit of the operations of the ACT Auditor-General and the ACT Audit Office, performed in accordance with section 29 of the *Auditor-General Act 1996*, is to form an independent opinion on:

whether the ACT Audit Office is achieving its legislative objectives effectively, and doing so efficiently, economically, and in compliance with the *Auditor-General Act 1996* and the relevant professional audit and accounting standards.

Terms of reference

In conducting the audit, the independent auditor is to have regard to the context and scale of the ACT (and ACT Audit Office), as well as better practice work in other jurisdictions to:

(1) Auditing function

Assess whether the existing audit methodologies, practices, and procedures are adequate and appropriate in undertaking the legislated functions of the Office as per section 10 of the *Auditor-General Act 1996*, including:

- a) compliance with relevant audit and accounting standards, including the recent requirement of APES320 'Quality Assurance for Audit Firms' issued by the Accounting Professional and Ethical Standards Board
- b) compliance with legislated requirements, in particular, functions listed in section 10 of the *Auditor-General Act 1996*, and
- c) the relevance and appropriateness of the *Auditor-General Act 1996* to facilitate delivery of better practice audits.

(2) Planning

- a) Review the selection criteria and risk framework for the selection of potential performance audit topics.

(3) Audit Framework and Methodologies

- a) Review the appropriateness of the ACT Audit Office's:
 - i. audit framework being employed;
 - ii. approaches and methodologies applied for scoping and conduct of financial and performance audits; and
 - iii. skills identification practices for conducting particular or specialist audits.
- b) Provide advice as to potential operational improvements for the ACT Audit Office relating to those items identified in (3) a), having regard to current and emerging national and international better practice.

(4) Management and resources

- a) Review the governance and management practices of the Office, including evaluation of the adequacy of internal risk management, operating procedures and controls, and operation of the Office's quality control systems.
- b) Assess the adequacy of the Office's human, financial and equipment resource and resource management practices.

- (5) Public accountability
- a) Determine whether the Audit Office is providing value for money financial audit services in comparison with the services and fees of similar organisations.
 - b) Determine whether performance audits conducted by the ACT Audit Office provide value for money by:
 - i. improving public accountability in the public administration of the Australian Capital Territory (ACT); and
 - ii. making recommendations that may lead to improvements in both the efficiency and effectiveness of public administration in the ACT.
- (6) Relationship/communication with stakeholders
- a) Assess the effectiveness of communication between the Office and its stakeholders, including:
 - i. the Legislative Assembly for the ACT;
 - ii. the Standing Committee on Public Accounts;
 - iii. the ACT Executive; and
 - iv. Chief Executives of ACT Government agencies and authorities.
 - b) Assess the standard and quality of service provided to the Legislative Assembly for the ACT.
- (7) Previous independent audit
- a) Assess and evaluate how well the recommendations of the 1998-99 independent performance audit of the operations of the ACT Auditor-General and ACT Audit Office have been actioned, and in particular, determine the extent to which they have been implemented and whether they are achieving their desired objectives.
- (8) Benchmarking
- b) Having completed (1) through to (7), and having regard to the scale of the ACT (and ACT Audit Office), make a comparative assessment of the economy, efficiency and effectiveness of the service delivery arrangements with at least one other Australian Auditor-General's Office but also assessing performance with consideration given to examples of international better practice.
- (9) General
- a) Review any other matters, as the independent auditor considers relevant, and provide advice on the potential for improvements to the economy, efficiency and effectiveness of the ACT Audit Office.
 - b) Review any matter that may be referred to the independent auditor by the Standing Committee on Public Accounts during the course of the audit.

Timing and reporting

The Audit is to be conducted during the 2009-10 financial year, specifically throughout the period to April 2010, with the intention that it be completed so that a report is provided to the Speaker, and subsequently the Legislative Assembly for the ACT, no later than the last sitting day of May 2010.

Audit scope

The Audit is to be conducted in accordance with the requirements of the *Auditor-General Act 1996*; relevant professional auditing and accounting standards; and professional statements and related guidance.

Appendix 2: Financial Report Audits Reviewed

- Department of Education and Training
- ACTEW Corporation Ltd
- University of Canberra
- Canberra Public Cemeteries Authority
- Gambling and Racing Commission
- Community Housing Canberra Ltd

Appendix 3: Performance Audits Reviewed

Audit	Report Date
Maintenance of Public Housing	August 2008
Management of Respite Care Services	May 2009
Delivery of Ambulance Services to the ACT Community	June 2009
Government Office Accommodation	August 2009

Appendix 4: List of Findings and Recommendations (with ACT Audit Office Responses)

Findings

- In implementing a new system of quality control to meet new standards, the Office has adopted a professional and thorough approach. *(page 8)*
- The Office's financial audit function is generally well-managed and professional. *(page 8)*
- Some aspects of the conduct of financial audit, particularly in relation to audit evidence, documentation and quality control, require attention to ensure full compliance with audit standards and the Office's own policies. *(page 8)*

Response: The Office will give further attention to its work in these areas, as part of the quality review processes applied to financial audit work and in training provided to staff.

- The Office has not formally determined that any of its audits should be subject to a quality control review as provided for in APES 320 *Quality Control for Firms*. *(page 10)*
- Audit sampling was performed at an interim date for most engagements. It was unclear in the audit documentation as to what further substantive procedures or substantive procedures combined with tests of controls were performed during the remaining period that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. *(page 11)*

Response: The Office considers the current approach to testing is sound and complies with the relevant auditing standards. However, the Office agrees it could have documented more clearly in the audit files the rationale for not extending sampling to cover the 'intervening period'. The instances where sample testing was not extended to cover the 'intervening period' between the completion on the interim work and the end of the reporting period, occurred when the Audit Office considered that this task was not necessary to gather sufficient and appropriate evidence to support the audit opinion.

- The Office's analysis of significant variances between current and prior period balances did not always adequately explain the reason for the variance. This does not meet the requirements of Auditing Standard ASA 520 *Analytical Procedures*. *(page 11)*
- Agencies' draft annual reports were not always reviewed in a timely manner. This does not allow for any errors or inconsistencies identified by the review to be amended in the annual report before it is published. *(page 12)*

Response: The Audit Office reviews all printed annual reports and website versions shortly after the date by which these annual reports are required to be tabled (30 September) and advises agencies of any significant errors for correction.

The Office does not believe this has presented a risk to reporting as there has been a very low number of inconsistencies identified from the Office's subsequent review of published annual reports and these have all been promptly rectified.

- Instances were noted where the documentation of the basis for the audit conclusion(s) needed to be improved, particularly where exceptions were identified in the sample being tested. *(page 13)*

Response: The Audit Office believes that the audit conclusions reached were sound, but acknowledges that documentation of the basis for these conclusions could have been better in the instances of exceptions identified by the independent auditor.

- Audit team debriefing meetings were not always documented to the extent required by the Office's IPSAM audit methodology. **(page 14)**
- The Office's performance audit function is generally well-managed and effective, and meets the requirements of ASAE 3500 *Performance Engagements*, but there is scope for attention to some aspects. **(page 15)**

Response: The Office will give further attention to its work in the areas identified by the independent reviewer as part of its continuous improvement and quality review processes and in training provided to staff.

- The Office's move to a new performance audit tool ('ASPIRE') is appropriate and should strengthen confidence in the Office's quality control and compliance with auditing standards. **(page 16)**
- The Office's new *Performance Audit Methods and Practices* (PAMPr) Manual provides a robust set of policies, practices and guidelines for the conduct of performance audits. **(page 16)**
- Documentation on individual performance audit files was generally maintained at an appropriate standard and audit findings reflected the evidence obtained. **(page 18)**
- Final costs of some performance audits over the last 3 years were substantially in excess of estimated costs, and there were some significant delays in their tabling. **(page 20)**

Response: The Office acknowledges that ideally there should be a reasonably close match between the initially estimated budget and timeframe for an audit and the final cost and tabling date. This, however, is not always feasible for a variety of reasons, especially given the constraints of a small audit team, and high staff turnover.

The initial budget approved with the early Audit Work Plan is based on factors known at the planning stage. The actual resource needs for the audit will be influenced by factors such as the complexity of the subject matter and administrative arrangements, the nature and quantity of the issues arising, the quality of the data available to audit, and at times the relationship with the auditee. These factors generally only come to light as the audit progresses and will often have a significant bearing on the cost of completing an audit and the timing of the audit.

- The Office has a very well-established and robust process in place to guide the selection of a performance audit program. **(page 25)**
 - The Office takes an active approach to managing and developing its staff and is conscious of the need to address the issue of staff retention. **(page 31)**
 - The ACT Audit Office's relatively small size does not appear to have impacted significantly on its cost structure or the quality of services it provides. Based on the evidence available, it appears to achieve high productivity from its staff. **(page 33)**
 - Notwithstanding the small population of the ACT, the Territory Government delivers much the same range of services as the larger State governments. To provide the ACT Legislative Assembly with a comparable level of assurance as to the efficiency and effectiveness of those services, there is a need for a broadly comparable performance audit program in the ACT. **(page 35)**
 - The Auditor-General's various reports are well-written and effective in informing Members of the Legislative Assembly and other readers of matters that are relevant to them in meeting their roles and responsibilities. **(page 39)**
-

- Audit clients (both financial and performance audit) were generally very supportive of the way the Office interacted with them, although some felt that the level of its expertise had fallen in recent years, possibly because of staff turnover. (page 42)

Response: The Audit Office agrees that staff turnover has adversely affected the progress of some audits and other projects. The Office accepts that staff turnover may have contributed to a reduction in the level of experience of auditors, and has adapted its management and quality processes to address the risks this may create.

The independent reviewer concluded that the Office has performed its financial and performance audit functions well, and in particular that the performance audits selected for review were conducted with appropriate documentation, and audit findings and conclusions were soundly based.

- The Office's annual staff surveys show very high levels of staff satisfaction, despite the impact of continuing staff shortages in some areas. (page 43)
- The Office takes its accountability to stakeholders seriously and is open in reporting on its performance, but there is scope for further improvement. (page 45)
- The Office has one of the best records of all state and territory audit offices for completing its financial report audits in a timely manner. Where it has not completed an audit according to its own timing benchmarks, this has largely been due to the agency concerned being late in submitting its financial report. (page 46)
- Despite the difficulties associated with high levels of staff turnover, the Office has a consistently good record in completing its performance audits in a short timeframe and at an average cost significantly below other jurisdictions. (page 49)
- The Office has implemented the substantial majority of recommendations it accepted from the 1998-99 Review, with most deviations satisfactorily explained. (page 50)

Recommendations

1. The Office should identify which of its audits are to be subject to an APES 320 quality control review and redesign its processes to allow such reviews to be undertaken before each audit opinion is issued. (page 10)

Response: Agreed. The implementation of an APES 320 Engagement Quality Control Review process for selected audits reflects better practice, and would enhance the review processes currently adopted by the Office.

2. The Audit Office should ensure that, where audit sampling for tests of controls and/or substantive procedures is performed at an interim date, clear evidence is included in the audit file outlining the audit procedures undertaken to cover the remaining period. (page 11)

Response: Agreed.

3. The Audit Office should consider including in the audit strategy a requirement for each agency to prepare a document explaining significant variances from previous year balances. The threshold variance amount or percentage requiring explanation could be agreed with each client. (page 12)

Response: Agreed. The Audit Office notes, however, that the suggested approach will require the cooperation of reporting agencies and, to be effective, agencies will need to have properly analysed their results prior to providing the requested information.

4. Analytical reviews comprising comparison of current year with prior year balances should be adequately explained in the audit file. *(page 12)*

Response: Agreed. The Audit Office will ensure documentation in this area is improved.

5. The Audit Office should remind audit teams of the need to liaise with those responsible for preparing the annual report to ensure the team is provided with a draft in a timely manner prior to publication. In exceptional circumstances where this cannot be arranged the auditor should clearly document the reasons in the audit file. *(page 13)*

Response: Agreed. The Office already requests, as part of the annual audit planning process, that agencies provide their draft annual reports to the Office for review prior to the issue of the audit report. The reporting agencies have not been able to comply with this request and this is most likely due to the tight timeframe for the tabling of annual reports in the ACT. Where agencies do not provide the draft annual report as requested, the Office will now document the reasons in the audit file as recommended by the independent auditor.

6. Financial audit staff should be reminded of the importance of ensuring sufficient and appropriate audit evidence on exceptions is documented in the audit files to support the conclusions reached. *(page 14)*

Response: Agreed.

7. The Office should remind audit teams of the need to ensure that audit team debriefing meetings are adequately documented. *(page 14)*

Response: Agreed.

8. The Office should consider holding team debriefings for small audits. *(page 14)*

Response: Agreed.

9. The Office should examine the issues identified by the recent Strategic Review of the Queensland Audit Office as to improvements needed to make ASPIRE fully functional. *(page 17)*

Response: Agreed. The Audit Office will obtain information on the issues relevant to ASPIRE identified during the Strategic Review of the Queensland Audit Office and consider their relevance to the introduction of the methodology in the ACT.

10. The Office should make it standard practice to provide agencies with a 'discussion paper' before substantial report writing commences, to aid earlier resolution of any differences of opinion between the Office and the agency concerned. *(page 19)*

Response: Agreed. The Audit Office already offers auditees an early opportunity to resolve differences of opinion, by communicating findings to the audited agencies throughout the audit as they arise, and providing reasonably comprehensive discussion papers or draft reports for discussion.

This approach generally offers auditees more information and context than a list of issues, and allows a more constructive discussion with the auditee focussed on key concerns. The Office typically conducts an exit meeting with auditee representatives, centred on the discussion papers or draft reports, to resolve differences in opinion or reported 'facts' before a proposed report is produced.

11. The Office should review its existing approaches to audit scoping and to scope changes to identify any improvements that may be warranted. (page 21)

Response: Agreed. As a standard practice, a post-audit review is conducted for performance audits, with input from the Auditor-General, Director, and audit team, to identify areas of improvement (in policies, procedures, or accepted practice), for application to future audit activities.

12. In its inquiry into the *Auditor-General Act 1996*, the Public Accounts Committee should consider the merits of moving to a fixed interval between section 29 reviews of the Audit Office. (page 22)

Response: Supported. The independent reviewer's recommendation is consistent with the suggestions made by the Audit Office in its submission to the Standing Committee on Public Accounts' Inquiry into the *Auditor-General Act 1996*.

13. In its inquiry into the *Auditor-General Act 1996*, the Public Accounts Committee should consider the merits of assigning full responsibility for setting the terms of reference for section 29 reviews and contracting with the reviewer to the Committee. (page 23)

Response: Supported. The independent auditor's recommendation is consistent with the suggestions made by the Audit Office in its submission to the Standing Committee on Public Accounts' Inquiry into the *Auditor-General Act 1996*.

14. In selecting its draft program of performance audits, the Office should ensure more rigorous estimating of the cost of each potential topic. (page 28)

Response: Agreed in principle. The Office will consider whether the recommended approach will provide any additional benefits to the current approach adopted by the Office.

Under the Office's current practice, at the early stage of audit selection process, the Office identifies proposed audits as small, medium, or large, with each category allocated a nominal budget based on the Office's experience with completed audits. This is sufficient for matching the proposed performance program to the Office's performance audit capacity. All audits included in the proposed performance audit program are considered to represent a good match between the resources required and the potential benefits from the audit.

The resource estimation process becomes more refined as the understanding of the subject is developed. At the time that the Audit Work Plan is approved, the audit objectives, scope, and approach will be better defined, and resources required will also be better assessed. The initial budget approved with the Audit Work Plan for each audit is based on factors known at the planning stage.

15. The Office should set its financial audit fees with the aim of recovering an appropriate share of the costs of office-wide projects and systems such as quality control (unless it receives additional appropriation to cover those costs). Financial audit costs should not be budgeted to require support from the existing appropriation or from cash reserves. (page 33)

Response: Agreed, subject to a further consideration of the benefits and costs of the recommended approach. The Office's practice has been to seek additional appropriation funding to meet the costs of significant whole-of-office projects because this approach is more transparent than including a levy in the audit fees charged to each agency for their 'fair share' of such costs. The Office notes that actioning this recommendation may result in an increase in audit fees.

16. The Office should compile and publish in its Annual Report, information on the cost of activities charged to the appropriation, including performance audit, protected disclosures, services to Legislative Assembly committees, etc. **(page 36)**

Response: Agreed in part. The Office will consult further with the Public Accounts Committee on whether there is a need for such information.

The Audit Office already regularly and clearly reports to the Legislative Assembly on the services delivered with the appropriation funds such as delivering the performance audit program, providing various reports to the Assembly; conducting investigations associated with public representations, examining public interest disclosure matters, and providing advice and services to Legislative Assembly Committees.

Given the Audit Office's small appropriation, it would not be efficient to compile additional cost information for external reporting for each of the services or products delivered, in addition to the comprehensive information the Office already provides in its annual reports and to various legislative committees.

17. The Office should implement a regular MLA opinion survey to obtain more formal feedback on its performance and should consider adopting the common survey instrument used by most other Australian audit offices. **(page 39)**

Response: Agreed. The Audit Office will seek formal feedback from MLAs on the performance of the Office.

The Office notes that given the small size of the ACT Legislative Assembly, it has reasonable contact with many MLAs and has frequent contact with the Public Accounts Committee. These contacts, as well as the regular monitoring of Assembly discussions and debates on the Office's operations in the Assembly, have provided good feedback on the performance of the Office. Nevertheless, the Office accepts that obtaining formal feedback through a survey may further assist the Office in monitoring its performance.

18. The Office should consider options for earlier submission of its report on the annual financial audits, including the option of issuing a supplementary report if the main report would otherwise be delayed by a small number of outstanding audits. **(page 41)**

Response: Agreed in principle.

The Audit Office has previously considered options for the earlier submission of this report and has concluded that to do so may compromise the quality of the report or incur additional costs, as well as leading to delays in other critical tasks performed following the completion of the financial audit program.

The summary report includes a significant component dealing with the audit of the whole-of-government financial statements. The outcome of this audit is not available until mid to late November. An earlier report to the Legislative Assembly (ie before December) would be much less useful as it would not include the Office's review of the whole-of-government financial report.

To date the matters raised in the report have not been time critical and the Audit Office would provide a report to the Legislative Assembly on any matter that it believes warrants earlier reporting. Also, any audit findings or recommendations that require urgent attention will have been brought to the attention of agencies in audit management reports which have also been provided to the relevant Minister.

19. The Office should consider reporting separately to the Assembly on the results of its audits of agencies with a 31 December balance date. **(page 42)**

Response: Not supported.

The Audit Office does not consider there is sufficient value in preparing a separate report for only a few agencies with a 31 December balance date. Should there be significant matters identified in the December audits that require the early attention of the Legislative Assembly, the Office can take appropriate action to report these matters to the Assembly.

20. The Office should consider making more use of the ACAG benchmarking survey data in reporting on its performance in its annual report. **(page 46)**

Response: Agreed. The Audit Office will consider the use of the ACAG benchmarking survey data in the reporting of its performance in its annual report.

The Audit Office has not previously included such information in its annual report because of the inherent limitations in benchmarking studies, such as the differences in the mandates of Auditors-General across Australia and different cost structures, and the one year lag in comparative data. Nevertheless, consideration will be given to using benchmark data where such use can provide meaningful insights into the performance of the Audit Office, and is consistent with the undertaking among ACAG members regarding the confidentiality and use of the survey data.

21. The Office should attempt to clarify the basis of the ACAG data on costs per financial audit opinion with a view to benchmarking its own costs. **(page 48)**

Response: Noted.

All measures in the ACAG Benchmark Survey are defined, including the inputs to the measures, in an attempt to ensure consistency in interpretation across participants. All Audit Offices have contributed to the ongoing refinement of the survey, and have tried to address as far as possible some issues on data inconsistency.

The issues raised by the independent reviewer reflect the inherent and practical limitations of benchmarking data, and further effort and resources by the Office to investigate the data provided by other Audit Offices is unlikely to result in any additional benefits to the Office.