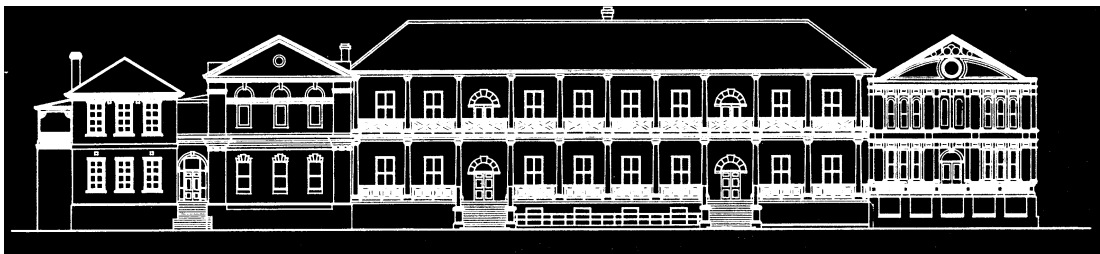




# **PUBLIC ACCOUNTS COMMITTEE**

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## **REVIEW OF THE AUDIT OFFICE OF NEW SOUTH WALES** under section 48A of the **PUBLIC FINANCE AND AUDIT ACT 1983**



**Report No. 2/52  
No. 120**

**February 2000**

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## **MEMBERS OF THE PUBLIC ACCOUNTS COMMITTEE**

Members of the Public Accounts Committee of the 52nd Parliament:

### **Mr. Joseph Tripodi, B.Ec. (Hons), MP, Chairman.**

Joe Tripodi was elected to Parliament in March 1995 as the Labor Member for Fairfield. Before entering Parliament he worked as an economist with the Reserve Bank of Australia and as a union official with the Labor Council of NSW. He has been a Member of the Committee since May 1995 and was elected Vice-Chairman in September 1996.

### **The Hon. Pam Allan, B.A. (Hons), Dip. Ed. (Syd.) Honours in Government, MP, Vice-Chairman**

Ms. Allan was elected to Parliament on 19 March 1988 as the Labor Member for Wentworthville. Prior to entering Parliament, Ms. Allan served as an Alderman on the Parramatta City Council and as a delegate and later became Chairman of the Western Sydney Regional Organisation of Councils. During her Parliamentary career Ms. Allan has served as the Minister for Environment and Shadow Minister for Planning, Environment and Women's Affairs. Ms. Allan has served as member of the Joint Select Committee on Waste Management and was elected to the Public Accounts Committee on 3 June 1999 and appointed Vice-Chairman on 23 June 1999.

### **Mr. Ian Glachan, MP**

The Liberal Member for Albury since 1988, Ian Glachan has had a varied background. He served five years at sea as a marine engineer, was a farmer for ten years, and operated a newsagency in Albury for 18 years. Mr Glachan is also a past president of the Albury-Hume Rotary Club and a Paul Harris Fellow, an active member of the Anglican Church, and was the Legislative Assembly member on the Board of Governors of Charles Sturt University. He is a former Chairman of the Public Accounts Committee.

### **Ms. Katrina Hodgkinson, MP.**

Ms. Hodgkinson was elected as National Party Member for Burrinjuck on 27 March 1999. Before entering Parliament Ms. Hodgkinson was Executive Officer to the Federal Cabinet Minister, Senator The Hon. Nick Minchin. Ms. Hodgkinson is a partner in a wool and fine arts retail enterprise. She is a former property developer and is a former member of several rural economic based committees. Ms Hodgkinson was appointed a member of the Public Accounts Committee on 3 June 1999.

### **Mr. Richard Torbay, MP.**

Mr. Torbay was elected an Independent Member for Northern Tablelands on 27 March 1999. Before entering Parliament, Mr. Torbay served the local community of Armidale. He is currently the Mayor of Armidale and has served in this capacity since 1995. He was previously Deputy Mayor and served on the Armidale City Council since 1991. Mr. Torbay has acted as Chairman of the NSW Country Mayor's Association, and is the Patron of Armidale District Chamber of Commerce. Mr. Torbay became a member of the Public Accounts Committee on 3 June 1999.

**Mr. Barry Collier, B. Comm., Dip. Ed., Dip. Law, MP.**

Mr. Collier was elected Labor Member for Miranda on March 1999. Before entering Parliament Mr. Collier was a Barrister practising criminal law (1997-98) and previously a solicitor from 1989 to 1996. Prior to being admitted as a solicitor, Mr. Collier was a high school teacher for 17 years, teaching economics, commerce and legal studies. He is a former President of the Legal Education Teachers' Association, a former Director of the Economics Teacher's Association, and is a published author having written *Introducing Economics 1, 2 & 3* - texts for HSC economics examination students. He chaired the NSW Economic Examination Committee for 3 years from 1985-1988. Mr. Collier was appointed a member of the Committee on 3 June 1999.

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## *Chairman's Foreword*

The review of the Audit Office of NSW undertaken every three years by the Public Accounts Committee is one of the Committee's most important functions. It serves to ensure that the work of the Auditor General remains accountable and of the highest standard. The Committee believes that the Peer Review report identifies and targets important areas for improvement and constructively prescribes ways in which the operations of the Office may be made more efficient and effective.

The Public Accounts Committee initiated its fourth tri-annual review of the Audit Office of New South Wales in 1998 under Section 48A of the Public Finance & Audit Act 1983. It met with the appointed reviewer, Professor Allan Craswell on a number of occasions to monitor the progress of the review and offer administrative assistance in relation to liaison with government agencies.

In discussing the progress of the review, the reviewer advised the PAC that, as auditing practices within the Audit Office evolved, they included a shift towards the auditing of management practices within government agencies. The reviewer advised the PAC that, whilst the last peer review emphasised the methodology of audits, the current review would stress the shift towards the auditing of management reflected in the increasing number of performance audits undertaken by the Office.

The Committee concurred with the findings of the reviewer that the future of auditing lay in the often-controversial arena of performance audits. However, the Committee conveyed to the reviewer its particular concern that performance audits over the years had lost sight of the distinction between government policy and assessments of the efficiency and effectiveness of management practices within government. The Committee expressed its concern to the reviewer over the way audits had frequently commented on government policy when Section 38D of the Public Finance & Audit Act 1983 expressly prescribes that :

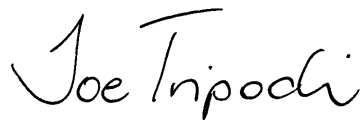
Nothing in this Division entitles the Auditor-General to question the merits of policy objectives of government...

The Committee sought from the reviewer a means by which the conflict between the Auditor-General and the Executive over what distinguishes policy matters from management and performance could be resolved. The reviewer's contract expressly required an assessment of the public statements made by the Auditor General and the extent to which policy matters were covered in those statements. Neither of these objectives were achieved to the satisfaction of the Committee, even though the reviewer is of the opinion that his report went some way in guiding the Committee on this matter.

The Committee was also concerned with the process governing the review under the Public Finance & Audit Act 1983. It felt that the finalisation of the review was unnecessarily delayed by the Committee's limited control over the review process as set out by the Act. The Committee plans to submit recommendations for change to Treasury as part of the Fundamental Review of Financial and Reporting Legislation that is currently in progress. The Committee plans to table a separate supplementary report detailing the difficulties it encountered in administering the Act during the review.

The Committee believes that the Peer Review is a comprehensive and detailed analytical undertaking which identifies important shifts in audit emphasis over the years and one which acknowledges the consistently high standards maintained by the Audit Office. The Committee would like to thank Professor Craswell for undertaking the review so professionally.

The PAC wishes to thank all government agencies who assisted the reviewer in compiling the report. The Committee also wishes to thank all those previous Members of the Committee who took part in the initial stages of the review. The Committee would like to thank those members of the Secretariat who co-ordinated the various inputs for this report.

A handwritten signature in black ink that reads "Joe Tripodi". The signature is written in a cursive, slightly slanted style.

Joseph Tripodi, MP  
Chairman

**REVIEW OF**  
**AUDIT OFFICE OF NSW**  
**under S48A**  
**of the**  
**PUBLIC FINANCE AND AUDIT ACT**



# PUBLIC FINANCE AND AUDIT ACT 1983

## Part 3 Division 5

### Section 48A Review of Auditor-General's Office

- (1) A review of the Auditor-General's Office is to be conducted under this section at least once every 3 years.
- (2) The review is to examine the auditing practices and standards of the Auditor-General and to determine whether the Auditor-General is complying with those practices and standards in the carrying out of the Auditor-General's functions under this Act.
- (3) The review is to be conducted by a person (the reviewer) appointed by the Public Accounts Committee for the time being constituted under Part 4.
- (4) The reviewer:
  - (a) is to be appointed on such terms and conditions and is entitled to such remuneration (if any) as are determined by the Public Accounts Committee, and
  - (b) in conducting a review under this section, must comply with any directions as to the review given by the Committee.
- (5) The remuneration payable to the reviewer is to be paid from money appropriated by Parliament for the purpose.
- (6) Sections 36, 37 and 38 apply in relation to the reviewer as if references in those sections to the Auditor were references to the reviewer.
- (7) The reviewer is to report to the Auditor-General as to the result of any such review and as to such other matters as in the judgment of the reviewer call for special notice.
- (8) the reviewer must not make a report of a review conducted under this section unless, at least 8 days before making the report, the reviewer has given the Auditor-General a summary of findings and proposed recommendations in relation to the review.

- (9) The reviewer must include in the report any written submissions or comments made by the Auditor-General or a summary, in an agreed form, of any such submissions or comments;
- (10) The reviewer, in a report of a review under this section:

  - (a) may include such information as he or she thinks desirable in relation to matters that are the subject of the review, and
  - (b) must set out the reasons for opinions expressed in the report, and
  - (c) may include such recommendations arising out of the review as he or she thinks fit to make.
- (11) The Auditor-General is to forward a report prepared under this section to the Public Accounts Committee within 2 months of receipt of the report.
- (12) The Chairman of the Public Accounts Committee is, on receipt of such a report, to present the report to the Legislative Assembly, if the Legislative Assembly is then sitting.
- (13) If at the time at which the Chairman seeks, in accordance with this section, to present the report to the Legislative Assembly the Legislative Assembly is not sitting, the Chairman is to present the report to the Clerk of the Legislative Assembly to be dealt with in accordance with section 63C.



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Mr J G Tripodi MP  
Chairman  
Public Accounts Committee  
Parliament House  
Macquarie Street  
SYDNEY 2000

24 December 1999

Dear Mr Tripodi

**Review of The Audit Office of New South Wales**

The Reviewer appointed by the Public Accounts Committee in terms of Section 48A of the *Public Finance and Audit Act 1983* has provided me with his report.

Under the Act, the Reviewer is required to incorporate my submission in the Report before I finally submit it to the Committee. However I understand that, by arrangement, the Committee has assumed responsibility for the Report's printing.

Accordingly, attached is the submission for inclusion in the Report. This replaces the submission provided to you dated 18 October 1999 on what this Office then believed to be the final Report.

Yours sincerely

R J Sendt  
Auditor-General

Encl: J:\AG\Papers\reviewAO24.12.99



## **REVIEW OF THE AUDIT OFFICE OF NEW SOUTH WALES**

The Audit Office welcomes the Report of the review by Professor Craswell.

In general, the Office would see his recommendations as worthy of consideration. Some indeed have already been implemented. Some, while of vital interest to the Office, are of course not within its own power to implement.

It is not the intention of this submission to analyse each section of the Report or each of the recommendations. However, there are some points that should be made.

### **THE ULTIMATE AIM OF AUDITING**

In the Assumptions Underlying the Review, reference is made to the ultimate aim of auditing is to improve the quality of management. In an earlier response to the Reviewer, the then Auditor-General advised that

*we have always held that our prime function is to help parliament hold the government accountable for the government's use of community resources and powers.*

A former Solicitor General thought this to be a useful summation of our tasks. If, in the exercise of that function, we are able to help the government or its agencies to improve efficiency (in its broad meaning) that is a bonus.

There need not be a conflict between helping Parliament and helping the Government. In most cases there would not be. But if there were, the accountability function would according to law have the priority, compared with the efficiency function.

The extent that this general divergency is contained within the review and the report thereon should be clearly understood by the readers and users of the report. (In some sections of the report this distinction is clearly enunciated.)

### **PARTNERSHIP OF INTERESTS**

The report includes the suggestion that the Auditor-General acts in partnership with others with the ultimate aim of enhancing the efficiency of public sector management.

Currently about 80 per cent of Audit Office resources relate to the audit of financial statements of individual entities and the public sector in total. The ensuing reports are aimed not at enhancing efficiency but in providing attestation as to relevant aspects of accountability.

Although ancillary reports such as management letters to individual entities can aid efficiency, this is not seen as the priority of the task set down for the Auditor-General by the *Public Finance and Audit Act 1983*.

To the extent that partnership is appropriate, this must not (and must be seen to not) compromise in any way the independence of the Office.

## **PERFORMANCE AUDITS**

The Audit Office believes that this section of the Report fails in a number of ways.

### **Project Selection**

The Report identifies the eight criteria used by the Office in selecting topics for performance audit. One of these criteria is whether the issue under consideration has wide or narrow applicability in the public sector. Other criteria being equal, the Office will give preference to a review that has wider applicability.

The Report is then apparently critical of the Office in undertaking “narrow” reviews that were specifically requested by Parliament. These reviews included *Sale of the TAB* and *Review of Walsh Bay*.

It is unclear whether the criticism is that the reviews were conducted or that they were conducted in a narrow manner. The former interpretation could be gathered from the adverse commentary on the above reviews, in comparison with more favourable commentary on a number of service-wide reviews (such as *Management of Sickness Absence*).

If this is the correct interpretation, it seems a strange argument that the Audit Office should not give the very highest priority to the desires of its principal “client”. Indeed in the case of the *Sale of the TAB*, the desire of Parliament for a review by the Auditor-General was embodied in legislation.

If the latter interpretation is correct, its accuracy is also to be questioned. The report on the TAB contained a number of recommendations for improving the process for any future business sales.

### **Perceptions of Performance Audit Reports**

The Report recognises the difficulties associated with evaluating performance auditing although at the same time acknowledges achievements of the Performance Audit Branch. On page vii of the Opinion and Conclusion section, the Report states:

*Performance audits are the most controversial of the Audit Office’s operations. However, when reviewed in terms of criteria adopted overseas, the Performance Audit Branch compares favourably with international best practice.*

In the chapter dealing with performance auditing, the Report reiterates the difficulties associated with evaluating performance auditing (page 29) and particularly the problems associated with evaluating individual reports. It states:

*One method of evaluating performance audits is to review the outcome of the process. Under this approach, individual reports are reviewed and a judgment made on each. The problem with this approach is that evaluating the report necessarily involves value judgements which are a matter of opinion and difficult to substantiate.*

*Discussions with senior staff at the General Accounting Office (GAO), Washington, DC, indicated that their approach was to evaluate the processes rather than to assess the outcomes. The benefits of reviewing processes rather than reports were reiterated in discussions with senior staff of the National Audit Office (NAO), London, and the Auditor-General of British Columbia (AGBC).*

Yet, notwithstanding these statements (and the Reviewer's earlier advice that he would not review specific audits), the Reviewer reviewed all 16 audits reports issued in 1998. The Report commented on two of these in some detail – *The NSW Senior Executive Service* and *The Redevelopment Proposal for East Fairfield (Villawood) Estate*.

These two reports were those that the Government had disagreed with most strongly. It is regrettable that in neither review was the current or previous Auditor-General, or the team involved with the audit, consulted.

Given the adverse nature of the commentary on these two reviews and the lack of any opportunity The Audit Office had to discuss the reviews, there is regrettably no alternative but to provide a detailed response in this submission.

- ***The Senior Executive Service Audit***

The Report states that there were serious criticisms by the Government of the method of analysis used in preparing the SES report. The clear implication is that in the report:

- we had errors of facts and interpretation,
- the evidence if examined is actually contrary to the Audit Office's assertions,
- the survey sample was inadequate
- the report did not provide a sound foundation for making rigorous and objective testing of the opinion expressed.

Many of these statements are direct quotes from the Premier's Department response to the audit report, with no apparent analysis of their validity.

The Report also asserts that there were problems in the Performance Audit Branch in that it was not able to properly interpret and apply the survey data because it was outsourced. As such the Report concludes that we should "contract-in" expertise and/or be trained in the area of survey design and analysis.

The Report recommends (Recommendation 21) that:

*The Auditor-General should investigate opportunities to ensure staff in the Performance Audit Branch receive appropriate training in survey design and analysis.*

The Report seems to have relied completely on the response provided by Premier's Department. This is unfortunate as the response was refuted in the strongest possible terms by the previous Auditor-General in a December 1998 letter to the Director-General of the Premier's Department. There is no evidence that this letter was considered in the course of the review.

In not seeking the views of those who were involved with the audit, vital information and facts were missed. It was missed that:

- the project leader for this audit was highly trained and experienced in survey design and analysis. It is a major feature of her credentials
- the University of Technology, Sydney (UTS) was extensively involved with the survey design and the procedures relating to it and the Premier's Department was consulted along the way
- the workpapers clearly evidence that the data was reviewed by us in extreme detail, and extensive questioning and interaction with UTS occurred over data interpretation and application
- extensive discussion took place between the Premier's Department and The Audit Office
- the final exit interview was conducted between the Director-General himself and the Auditor-General.

By referring to the Premier's Department comments without seeking to form a view as to their validity, the Report implicitly supports them. The Audit Office would have welcomed a detailed examination of our workpapers, which show that for every point raised by Premier's Department, we reviewed our material and reached a decision about any changes deemed necessary. To our knowledge, no errors of fact remained at all. Disagreements about interpretations perhaps, but this is quite different. As to the point about inconsistencies with the survey data, we specifically reviewed these claims and had UTS do likewise so that we could be confident that everything we were saying was supported by the data.

It is interesting that the Deputy Director-General of Premier's Department recently stated that the Department was aware that sufficient numbers of SES officers were dissatisfied with the SES system and would prefer to opt out of the SES and into the senior officer classification, to warrant the Department looking into the issue.

These comments and actions would seem to indicate that despite the official response, the SES report had merit and validity.

In respect of the recommendation relating to training staff in survey design, it should be noted that whilst the Performance Audit Branch was involved with the survey design and interpretation, the conduct of the survey was outsourced. The logistics required to support large complex surveys, with much follow-up action and data input required, are not available in the Branch. The Branch supports small surveys in-house, but it is far more efficient and effective to outsource large ones such as the SES. To develop such a capacity in-house would be appropriate if there were sufficient large surveys to justify it. And that is not the case. On that basis the recommendation has very little significance or applicability.

- **The Villawood Audit**

The comments in the Report on the Villawood audit are also viewed with concern.

The Report draws an incorrect inference that the Villawood Report has wider implications than commenting on the assessment process adopted by the Department of Housing. It concludes that to maximise benefits from the audit, recommendations should have been directed at NSW Treasury (to improve its guidelines for conducting economic appraisals of capital projects) rather than the Department of Housing.

We would disagree with this conclusion on the basis that the audit did not find fault in the economic appraisal guidelines issued by NSW Treasury but rather the Department of Housing's failure to follow these procedures. The Department of Housing did conduct a cost/benefit analysis in line with Treasury guidelines but did not follow these guidelines in making its final decision (the guidelines indicate that the project with the highest BCR should be chosen).

At no stage had the Department of Housing approached NSW Treasury for assistance in conducting an economic appraisal or developing cost estimates for the redevelopment of Villawood.

It was agreed that the Department of Housing should, in consultation with NSW Treasury, develop estimates of costs and benefits that could be used for future housing projects. This is reflected in the Report's recommendations.

The audit did not consider that the economic appraisal guidelines recommended by NSW Treasury were inadequate to evaluate this type of project; and that responsibility for developing reliable and valid cost estimates was the responsibility of the decision maker.

It should also be noted that the segments of the draft report that related to the activities of NSW Treasury were forwarded for comment prior to printing the report. NSW Treasury raised no objection and cleared the comments for print.

## **Integration of Audit Staff**

Recommendation 20 states:

*The Auditor-General should consider the benefits of integrating the staff in the Performance Audit Branch with the Financial Audit Branch to establish teams which are skills based and can more efficiently identify areas for improvement in public sector management.*

The Audit Office understands the logic that gives rise to this recommendation. In a less imperfect world, it would be unexceptionable.

The reality however, is that individuals largely (but not always) possess skill sets that attract them to, and allow them to perform better the functions of, financial auditing or performance auditing. The Office makes this point while fully recognising that the "standard" financial auditing function has increasingly adopted many of the approaches that characterise some of the key competencies (risk assessment, systems analysis) of a performance auditor.

Nevertheless, while performance auditing remains substantially the smaller of the two major Audit Office functions, a team-based approach would risk spreading the performance audit skills set too thinly to be effective.

## **CLIENT SATISFACTION**

Recommendation 26 under this heading states (in part):

*The Auditor-General should endeavour to improve the value-added elements of auditing by ensuring that ... the areas of concern to management are specifically addressed.*



Addressing management's concerns may be a worthy goal. However I would have reservations if this resulted in the independence of the Office being eroded or being seen to supplant what is more properly the role of internal audit (or other internal management review mechanisms).

The concern is more so if Audit Office resources are diverted from their principal function.

## **ACCOUNTABILITY**

Recommendation 29 states:

*The present system of funding the Audit Office based on fees collected from audit clients should be retained.*

I support this recommendation if it simply states a preference for financial audits continuing to be funded by client fees.

However I do not necessarily support the status quo arrangement in respect of special ("performance") audits. These, I believe should (in general) be funded from a specific Consolidated Fund allocation. (A corollary to this position may be that the Office becomes subject to the tax equivalents regime and dividend policy.)

## **CONCLUSION**

Other than much of the material on performance auditing, the Audit Office welcomes the Report. The Office is appreciative of the benefits to be gained from the implementation of many of the recommendations contained in the report.

R J Sendt  
Auditor-General