



## PUBLIC ACCOUNTS COMMITTEE

# REVIEW OF THE AUDIT OFFICE OF NEW SOUTH WALES under Section 48A of the PUBLIC FINANCE AND AUDIT ACT Volume One



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

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**VOLUME 2**

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FULL TEXT**

**1. THE PROCESS OF THE REVIEW**



This Review of the Audit Office is mandated by section 48A of the *Public Finance and Audit Act* 1983, which provides that the Public Accounts Committee appoint a “reviewer” of the Auditor-General’s Office at least once every three years, and that 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 the Auditor-General’s functions under this Act*”.

In this instance, the Public Accounts Committee appointed a Panel, in November 1994, to undertake the review. The Panel was structured to contain a balance of independent practitioners from the public sector, the private sector, and the academic and professional accounting worlds.

The Panel is “the Reviewer” in terms of section 48A of the Act. The terms of reference for the entire review, as approved by the Public Accounts Committee, are in Appendix 1.

The members of the Panel are:

Flav Belli

Group General Manger (Audit), ANZ Banking Group; and previously Deputy Auditor-General, Victoria; Member, Auditing Standards Board (1993-5).

Jim Brophy

Principal, Brophy Management Services;

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previously Commissioner for Land Tax, NSW.

Allen Craswell

Professor of Accounting, University of Sydney; Member, Auditing Standards Board (1992-4).

Stan Droder

Director, Australian Society of CPAs (NSW Division); Member of the Council on the Cost of Government; previously a Group General Manager within CSR Ltd, (Nominee of Australian Society of CPAs).

John Spencer

Partner, Felser Russell, Chartered Accountants; Executive Director, Local Government Auditors Association (Nominee of Institute of Chartered Accountants in Australia).

Tom Sheridan (former Auditor-General of South Australia) was originally a member of the Panel, but subsequent to the commencement of the Review, the Public Accounts Committee requested him to assume a consultancy role, to co-ordinate the work of the consultants listed below, and, as well, to report on the Auditor-General's independence, mandate and mission.

In order to obtain a solid foundation on which to base its report, the Panel advised the PAC that supporting work needed to be carried out and would be best undertaken in five separate segments. Thus, to obtain the best balance of skills in each segment, it was decided to publicly seek tenders for each segment separately. The following contracts for this supporting work were let:

Price Waterhouse	Management of the Audit Function
Price Waterhouse	Management of Human Resources
Ernst & Young	Conduct of Financial Audits
Ernst & Young	Management and Use of Technology
Coopers & Lybrand	Performance Audits

Professor John Glynn of the University of Kent, a world-renowned expert on public sector performance auditing, was also asked by the PAC to contribute a brief report on the NSW Audit Office's Performance Auditing operations. The recommendations by Professor Glynn are included in the report as Appendix 2

The recommendations contained in the Panel's report are based upon an assessment of the findings of the consultants and the Panel's own observations and inquiries.

**The Report of the Panel, which is the Review Report in terms of section 48A of the Act, is contained in Chapter 2.**

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Also included are reports of the consultants. These reports contain recommendations which, together with the recommendations of Professor Glynn, should be considered by the Auditor-General in terms of improving the economy, efficiency and effectiveness of his operations.

## **DIFFERING VIEWS**

### **Public Accounts Committee**

The reader will note that the Panel, on the one hand, and two of the consultants, on the other, held differing views about the role of the Public Accounts Committee vis-à-vis the Auditor-General. Two of the consultants believe that the PAC should review and discuss the annual and forward performance audit plan with the Auditor-General, and should recommend to the Treasury the resources the Auditor-General requires to undertake the audit plan. The Panel, however, firmly believes this is not an appropriate role for the PAC. The Panel believes that the PAC cannot at one and the same time:

- approve the Auditor-General's forward plan and recommend to Treasury the resources for carrying it out;
- critically evaluate the plan and its implementation on behalf of the Parliament.

It would clearly be inconsistent for the PAC to evaluate, with the necessary objectivity and independence, a plan it had already approved.

The Panel believes the objectivity and independence of the Public Accounts Committee are non-negotiable requirements, and is firmly opposed to any measure which might be seen as compromising them.

**The Reviewer recommends that the PAC not be involved in approving the Auditor-General's forward plan or in recommending to Treasury the resources for carrying it out.**

### **Compliance audit**

The Review recommends that legislation should be amended to include specific reference to compliance auditing. Two of the consultants make differently phrased recommendations on the subject of compliance auditing. Notwithstanding the consultants' recommendations, this Review should be taken as recommending that compliance auditing be dealt with specifically and separately in the new legislation.

## **. 2. THE REVIEW REPORT**





## **STATUTORY REPORT**

To the Auditor-General and the members of the New South Wales Parliament

### **Scope**

We have conducted a review of the Audit Office of New South Wales under S 48A of the Public Finance and Audit Act 1983

Our review involved determining the matters to be reviewed, the appointment of consultants to conduct detailed reviews of the matters determined, an assessment of the reports of the individual consultants and our own investigations and considerations of the issues involved.

Our review of the reports of the individual consultants was carried out in order to evaluate the recommendations of the consultants, to ensure uniformity across all areas of the review and to form an opinion on whether the recommendations were appropriate.

We have also conducted our own limited investigations.

These procedures have been undertaken to form an opinion as to whether, in all material respects, the Auditor-General is complying with the practices and standards of the Audit Office and applicable professional standards and practices and statutory requirements so as to express an opinion on the review which is consistent with our understanding of the Auditor-General's standards and practices.

The opinion expressed in this report has been formed on the above basis.

### **Opinion**

In our opinion, and having regard to the findings of the attached reports, the Auditor-General is complying with the standards and practices of the Audit Office and applicable professional standards and practices in carrying out the functions of the Auditor-General under the Public Finance and Audit Act, 1993.

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Insert names of panel members and signatures on original.

## **A. OVERVIEW OF THE AUDIT OFFICE**

### **FINDING**

*The Review found that there has been a growing awareness by the Audit Office of NSW of the need to improve the efficiency of its operations and to enhance the effectiveness of its mandate.*

### **FINDING**

*The Audit Office of NSW has invested a great deal of effort in developing and introducing new operational standards and procedures to improve its effectiveness and efficiency. The benefits of this effort will increase in future years.*

While the Auditor-General has made considerable effort to introduce and develop best practices, the issues involved are complex, particularly in the areas of the Auditor-General's enabling legislation and the conduct of performance auditing. To facilitate the process a number of these issues need to be addressed as a matter of urgency.

This report identifies the more important issues under consideration, the results achieved by the Audit Office and the further action that is required.

In reaching this conclusion, the Reviewer took into account the results of the 1989 KPMG Review of the Audit Office, the PAC's 1990 and 1993 Reports and the 1995 consultants' reports from the current review.

### **FINDINGS**

In summary, this Review has found, with respect to each of the segments of the report, that:

- *Management of the Office has improved. There has been major cultural change and the Office is working toward a focus on adding value for the client as opposed to concentrating on internal issues.*
- *Management of Human Resources has also improved. The range of competencies has been increased and the office is now in a better position to address emerging issues of financial management;*
- *Management of Financial Audits comply with legislative and professional requirements in accordance with Australian Auditing Standards.*
- *Management of Information Technology has improved particularly in the last six months of 1995.*

- *Conduct of Performance Audits is the most controversial part of this Review. While some of the reports were of considerable benefit to the taxpayer, others generated debate as to the outcomes. A better process of selection, objectives and reporting needs to be put into place to ensure the process is seen to be cost effective. The Panel is concerned about the cost of performance audits despite the Auditor-General's assurances that the costs are appropriate.*

Development within the auditing profession is continually undergoing change both in Australia and overseas and the Auditor-General must continue to maintain a current awareness of these changes so as to ensure that world best practice is implemented in his office.

### **FINDING**

*The Review Panel found that the independence of the Office and the level of advice available to the Auditor-General could be enhanced if an external advisory panel was established. Such a panel could have the role of providing expert advice to the Auditor-General on both technical accounting and auditing issues. Ideally the panel should be independent of the audit clients of the Auditor-General and should be comprise some 5-7 members drawn from the private sector, the professional bodies, the academic community and another public sector audit office.*

*The panel should be seen as complementing the internal resources available to the Auditor-General and have the following tasks and responsibilities:*

- *provide an independent source of advice on accounting and related issues*
- *provide high level advice on the ongoing review on the audit methodology used by the office*
- *provide an independent review mechanism to report to the Parliament on the proposed audit program of the Auditor-General.*

*It is envisaged by the review panel that the panel would meet at least once each quarter and that members would be paid a fee in compensation for their time out of funds appropriated to the Public Accounts Committee for the purpose.*

*The Panel would report annually to the Parliament, through the PAC, on the results of their work.*

**RECOMMENDATION 1**

The Auditor-General should establish an external, independent Advisory Panel for consultation on all aspects and functions in the management of the Audit Office, including Performance Audits and Audit Methodology. The Advisory Panel should be composed of a balance of leading experts currently working in the private sector (provided appropriate levels of independence are maintained), the professional bodies, the academic community and another public Audit Office. The Panel should consist of 5 - 7 members and be appointed and funded by the Public Accounts Committee in consultation with the Auditor-General. The Panel should meet at least quarterly and report annually to the Parliament through the Public Accounts Committee.

**B. IMPROVEMENTS IN THE LEGISLATION****(I) Current legislation combines finance and audit****FINDING**

*There is a fundamental problem with the current legislation: it inappropriately combines financial management matters and audit administration under the one piece of legislation and makes the Treasury responsible for both.*

As far as the Audit Office is concerned, the Panel sees this as a problem of independence. The Treasury is a major client of the Auditor-General and sets accounting policies and practices for the public sector. However, the Treasury may influence the scope of the audit through its role in administering the audit provisions of the Act. The Panel sees this as a conflict of interest with the potential to affect the independence of the Auditor-General.

**RECOMMENDATION 2**

The audit provisions of the Public Finance and Audit Act, including responsibility for setting the level of the Auditor-General's resources, should be moved to a separate, dedicated Audit Act administered by the Premier.

**(ii) Artificial Distinction among Different Types of Audit**

The Act currently divides audits into the following categories:

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- the public accounts
- government departments
- statutory bodies
- particular audits
- special audits

### **FINDING**

*The Act does not provide consistent audit scope and audit reporting requirements for all the categories of audit it covers.*

These differences emerge when contrasting section 35 (4), which gives a general power to report exclusively to the Treasurer, to the elaborate and expensive reporting requirements of Division 2A (Special Audits), which provide instead for public reporting to the Parliament.

To his credit, the current Auditor-General has not taken the easy option of doing all his additional audits under section 35 (4). He has chosen instead to undertake special audits, which must be tabled in the Parliament. The more stringent requirements of Division 2A, however, make the preparation of a special audit a time-consuming and expensive exercise.

### **RECOMMENDATION 3**

Within the framework of the current review of the Act, the five existing categories of audit should be removed by consolidating into one statutory requirement the general power of the Auditor-General to audit and report on public sector bodies.

### **(iii) Access to Information**

#### **FINDING**

*A major issue in NSW has been the right of access by the Auditor-General to Cabinet documents and other documents subject to legal professional privilege, in order to aid his audit process and to provide him with access to all relevant and necessary information to complete his audit function.*

This issue has been raised by both Auditor-General and the PAC.

The Panel believes that the Auditor-General should have access to information on matters that have a direct impact on the conduct of his audit. Denying him access to such information would constitute a limitation of the scope of his audit.

However, the Panel believes that there are certain limitations to this access. It should not extend to Cabinet submissions or other information used by the Cabinet to arrive at its decision. When any necessary legislation is being drafted care should be taken to ensure that the appropriate balance between Cabinet confidentiality and the right of an auditor to obtain information is maintained. This is a matter that the Public Accounts Committee might like to consider in detail as part of an ongoing review of the Act.

When dealing with the documents to which he has restricted access, the Auditor-General should at all times exercise an appropriate level of discretion.

#### **RECOMMENDATION 4**

The Auditor-General should have right of access to the final decisions and resolutions of the Cabinet which are necessary for him to establish government policy and to complete his audit.

The Auditor-General or an auditor authorised under section 35. (1) of the Act should have access to documents protected by legal professional privilege which are necessary for him to complete his audit. In exercising his right of access, the Auditor-General should always be cognizant of his responsibility to ensure the confidentiality of protected documents is maintained.

#### **(iv) Parliament's Intentions on Auditor-General's control of his staff not carried out**

Division 1A, incorporated into the current Act in a 1991 amendment, says, broadly:

“The affairs of the Auditor-General's Office are to be managed by the Auditor-General”.

It provides that the Auditor-General's office is to be constituted as a body corporate for the purpose of employing staff and determining salaries and conditions of employment for staff.

This provision was designed to strengthen the Auditor-General's independence from government.

#### **FINDING**

*Division 1A of the Public Finance and Audit Act has never been proclaimed. As a result, the Parliament's stated intent to strengthen the Auditor-General's independence has never been implemented.*

The Panel considers this particularly unfortunate. The Panel is of the view that all possible

measures should be taken to strengthen the independence of the Auditor-General from central government, and that it is desirable for the Auditor-General, subject to regular oversight by the PAC and to the three-yearly review mandated by section 48A of the Act, to manage his own resources.

**RECOMMENDATION 5**

Division 1A of Part 3 of the current Act should be proclaimed as soon as possible. As part of the current review of the Act, consideration should be given to retaining Division 1A of Part 3 or including it in any new legislation.

**(v) Ability of Auditor-General to provide value-added services**

**FINDING**

*A recent interpretation of the legislation restricted the Auditor-General's Office to providing merely after-the-event audit services. The Panel holds the view, however, that value-added services can be provided without impinging on the independence of the Auditor-General.*

The Auditor-General is in a good position to share proven techniques with disparate agencies and thus improve the public sector overall. He should thus be permitted to advise clients on how to improve the quality of their reporting and the efficiency of their operations. This is consistent with international best practice.

**RECOMMENDATION 6**

The new legislation should give the Auditor-General explicit authority to provide value-added services in addition to after-the-event audit services.

**C. PARLIAMENTARY OVERSIGHT OF THE AUDITOR-GENERAL**

It has been suggested by one of the consultants that the role of the Audit Office would be enhanced by the appointment of an audit committee of the Parliament and the PAC was nominated as being a committee who could appropriately fill that role.



The Panel is of the view that this is not an appropriate role for the PAC. Indeed, its role could subsequently be compromised if it has committed itself to supporting a course of action at the commencement of an event rather than being the “watchdog” which reviews actions after the event.

It is important to point out that the two most important independent “watchdogs” in the public sector accountability process are the PAC and the Auditor-General. Neither must be compromised by having their independence impaired in any way.

It is, perhaps, relevant to say that an audit committee (per se) has an important role to fulfil. The Panel has no objections to (and indeed supports,) the establishment of audit committees by auditees of the Auditor-General. The meetings of such committees would naturally be attended by one or more representatives of the Audit Office. However, the Panel does not consider that it is the role of the PAC to act as a parliamentary audit committee - indeed, it has reservations whether it is at all useful to establish a “parliamentary audit committee” as such. It does, however, encourage the formation and operation of audit committees for individual auditees as a matter of sound corporate governance.

#### **RECOMMENDATION 7**

The Public Accounts Committee should retain its current role and should not act as a parliamentary audit committee nor make recommendations to the executive on the level of resources required by the Auditor-General.

## **D. FOLLOW-UP MECHANISMS**

### **FINDING**

*There is concern as to the appropriateness and efficacy of the follow-up mechanisms in place to ensure that matters raised in the Auditor-General’s reports are adequately considered by government.*

This concern was raised by a number of the consultants.

The Panel holds the view that the Public Accounts Committee is an eminently suitable body to undertake this review. The Public Accounts Committee’s prime role is to ensure that financial savings and improvements in administrative procedures are achieved in the public sector. It is thus an appropriate body to examine how well the public sector savings and improvements recommended by the Auditor-General have been implemented by the Government.

However, it is very difficult for the Public Accounts Committee to carry out such reviews

adequately with its current level of resources. The Panel notes that the present level of resources allocated to the Committee were determined some years ago when the Auditor-General tabled one report per year. Since that time the number of reports has risen to about 15 per annum, with the rate set to increase in the future. Furthermore, the depth and scope of the reports have increased substantially. The Panel thus considers there is a clear need to ensure that the PAC is sufficiently resourced to adequately undertake these follow-up reviews.

**RECOMMENDATION 8**

An adequate level of resources should be allocated to the PAC as soon as possible to enable it to undertake timely and effective follow-up reviews of Auditor-General's reports.

**E. PERFORMANCE AUDITS**

**(i) Current legislation confines Auditor-General to current activities**

**FINDING**

*A recent interpretation of the legislation raises uncertainty as to whether the Public Finance and Audit Act only permits the Auditor-General to review activities which the Department "is carrying out", or whether it also permits him to review activities or programmes which have been completed at some time in the past.*

While the uncertainty is perhaps unintended, it is nevertheless very important to establish greater clarity. This is because the legislation, in its present wording, can be used to prevent the Auditor-General from gaining access to review programmes or activities which have been completed.

**RECOMMENDATION 9**

Section 38B of the Act should be amended to read "is or has been carrying out", thereby enabling the Auditor-General to audit activities or programmes which are no longer current.

**FINDING**

*Legislative anomalies appear to be addressed only every three years when a review is undertaken.*

This is of considerable concern to the Panel.

**RECOMMENDATION 10**

The Public Accounts Committee should, as part of its regular ongoing examination of the Auditor-General's reports, address the effect of legislative impediments to the full exercise of the Auditor-General's function.

**(ii) Economy, efficiency and effectiveness**

The issue of whether the Auditor-General should focus on all three of these aspects of an agency's performance has been a vexed one in the past.

**Finding**

*Every performance audit may contain an element of economy, efficiency and effectiveness.*

The Panel believes that the Auditor-General should address and report on all three elements. The Auditor-General should exercise professional judgement in determining how much each of these aspects should be weighted in performance audits.

**RECOMMENDATION 11**

In his performance audits, the Auditor-General should address and report on each of the three elements of economy, efficiency and effectiveness, but should be given full professional discretion on how much weight, if any, is to be given to each.

**(iii) Policy**

The Public Accounts Committee heard in evidence comments to the effect that the Auditor-General frequently comments on policy in performance/special auditing. The issue of what constitutes policy has been the subject of several legal opinions sought in NSW.

The Panel considers there is a simple solution to this problem.

**FINDING**

*The Auditor-General has been frustrated in carrying out his role in the area of special audits because the authority responsible is unable to provide a statement of government policy to support the programme.*

This is a matter of some considerable concern. In a recent case, the Auditor-General was advised by Crown Solicitor not to table a report on a performance audit programme of the 3x3 Program after spending some \$224,000 on the audit. The reason for the advice appears

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to be the lack of available documentation to indicate government policy in clear and unambiguous terms.

The Panel believes that if no statement of government policy can be produced the Auditor-General should report that to the Parliament rather than be impeded by administrative inefficiencies backed up by defective legislation.

#### **RECOMMENDATION 12**

The legislation should be amended to provide that -

- before a performance audit is commenced, the Minister responsible be requested by the Auditor-General to provide, within a specified time, a written statement of the policy relating to the programme or activity which is to be the subject of the performance audit;

- if the Minister provides a statement of policy which the Auditor-General considers restricts the accountability process, then the Auditor-General is to report the matter to the Parliament and seek direction; and

- if the Minister does not provide a statement of policy within the specified time, the Auditor-General is to report to the Parliament the absence of a policy for the programme or activity.

#### **(iv) Pooling of staff resources**

In their reviews of the Performance Audit and the Information Systems Branches, both Coopers & Lybrand and Ernst & Young recommend that the staff of both branches should be more integrated with the Financial Audit Branch.

The Review Panel noted that the Audit Office response to the expansion of the Audit Mandate had included a noticeable increase in the range of skills and job competencies of staff. In particular, Price Waterhouse in their review noted that the quality of staff had improved in recent years.

The wider range of skills now on staff at the audit office has given rise to a cultural mix. At the same time the overall increase in staff numbers has resulted in more office space being obtained. Unfortunately the choice of Office space has resulted in a bunker mentality among certain sections of the staff. Price Waterhouse found that the existing arrangements had resulted in “ *...some resentment and absence of cohesive teamwork*”.

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The Review Panel noted overall support by the individual reviewers for the integration of the various branches of the office. However, the feasibility of such integration is open to question. Notwithstanding this uncertainty, it is still the case that :

**FINDING**

*To improve the efficiency and effectiveness of operations better communication among the different branches of the Audit Office is essential.*

Consequently, as a first step,

**RECOMMENDATION 13**

New accommodation should be sought, or existing accommodation shared, to remove artificial internal barriers to greater communication and co-operation between branches.

In addition, establishment of industry groups is likely to improve the overall quality of services provided to clients and lead to synergies in adding value.

Integration with Financial Audit will expose members of other branches to field activities they would otherwise not experience and may well identify issues relevant to their particular area of expertise.

The Panel notes that the Audit Office has already established a number of industry groupings.

**RECOMMENDATION 14**

The Audit Office should continue to promote industry groups as a way of encouraging the financial, performance and information technology branches to work closely together, so that clients obtain the best service from the most appropriately qualified staff.

**(v) Cost of Performance Audits and its Relationship to Setting of Objectives**

The planning and performance of Special Audits (Performance Audits) is a matter of concern to the Panel, particularly in the absence of external benchmarks.

**FINDING**

*In some cases reviews have been carried out without pre-determined objectives; the time*

*taken and cost incurred in carrying out the reviews are greater than what might be expected from a commercial supplier.*

The Auditor-General should ensure that steps are taken to develop appropriate objectives and performance targets for a performance audit before the audit commences.

**RECOMMENDATION 15**

The objectives of a performance audit should be clearly set before the work commences.

This will mean a significant change for the Auditor-General's staff. Resources will need to be directed where objectives (pre-determined) decide that the results will provide the greatest "payback" in the terms of dollars or accountability to the community through the Parliament.

**FINDING**

*Statistics indicated that the "average" time for a performance audit to be completed was about 9 months.*

**RECOMMENDATION 16**

In order to improve the relevance of the recommendations in his performance audits, the Auditor-General should aim to reduce the average time taken. Complex assignments may need more staff to be assigned or broken down into separate, more manageable, parts.

## **F. PERFORMANCE INDICATORS**

One of the features of the current annual reporting legislation<sup>1</sup> has been the creation of a common set of reporting requirements for departments and agencies, which included performance indicators. These indicators are detailed in the regulations and contain a requirement to include qualitative and quantitative measures and indicators of performance. However, these legislative requirements have rarely been fully satisfied in practice.

**FINDING**

*Legislative provisions requiring the inclusion of qualitative and quantitative performance measures in an agency's annual report have rarely been fully satisfied in practice.*

This is a pity. The reporting of performance indicators by agencies in their annual reports can go a long way in opening up agencies to external scrutiny. However, one of the major deficiencies which still exist is that current annual reporting requirements does not require

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<sup>1</sup>Annual Reports (Departments) Regulation 1986, clause 3(h).

any independent scrutiny of the non-financial assertions made by management. By comparison the credibility of externally reported financial information is assured by an independent auditor signing off an audit opinion to the financial statements.

Under Australian Auditing Standard AUS 212 an auditor has a professional obligation to consider other information contained in published annual reports and to check for any material inconsistencies. This does not go far enough in attesting the validity of the non-financial assertions made by management. What is needed is an audit of the non-financial data.

### **FINDING**

*The current annual reporting process could be improved if the auditor was required to attest to the assertions made by management in annual reports about their agency's performance.*

On the other hand, financial performance measures (the financial statements) are supported by an external assessment in the form of an audit opinion. This is accepted industry practice.

Some jurisdictions, e.g. New Zealand and Western Australia, do provide for such external scrutiny of reported performance indicators. This scrutiny takes the form of an Auditor-General's opinion on the performance indicators.

The Panel sees considerable merit in this approach. We have several reasons:

- Because the audit is attesting against an existing set of criteria, it is a much simpler process than undertaking broad scope performance audits.
- It is therefore much less costly than a series of full-blown performance audits.
- It can cover all agencies, every year, instead of a few, as is the case with performance audits.
- It can be done by appropriate and integrated, skilled audit teams instead of needing to be carried out by a whole new team of specialised performance auditors.

### **FINDING**

*The Panel considers that the Auditor-General's mandate should be expanded to include reporting on performance indicators.*

Setting the performance indicators in the first place is a difficult and responsible task, because performance indicators relate so closely to government policy. Therefore one appropriate mechanism for setting the indicators could be a joint exercise carried out by:

- the Agency's governing board (not management);
- central agencies of government;
- customer councils, composed of customer representatives.

**RECOMMENDATION 17**

More attention should be given to the identification and development of key performance indicators, to be included in the Annual Reports of agencies.

**RECOMMENDATION 18**

The Auditor-General's role should be to attest to the accuracy and relevance of an agency's published performance indicators, and should not include setting the indicators.

**RECOMMENDATION 19**

Legislation should be introduced to give the Auditor-General specific responsibility to express an opinion on the accuracy and relevance of an agency's published report of performance indicators.



## **F. COOPERS & LYBRAND PERFORMANCE AUDITS**

### **FINDING**

*While accounting standards, legislation and academic literature are unequivocal about the concerns of performance audit with matters of economy, efficiency and effectiveness, guidance contained in the academic and professional literature about the subject matter, and the methodology, of performance audit varies considerably.*

### **RECOMMENDATION**

The work of the Auditor-General in the area of performance audit have a focus on:

- economy, efficiency and effectiveness of agency management practices, operations and service delivery - developing and applying “criteria based” audit methodologies;
- broad sector or government wide studies to identify audit criteria, benchmarks and best practice that have general application for use in direct audit assignments across particular agencies;
- development of frameworks and the auditing of the accuracy and relevance of performance statements prepared by agencies (attest audit);
- auditing of performance statements and indicators contained in performance statements as to validity, relevance and accuracy.

### **FINDING**

*There is no academic qualification in “performance audit”. The discipline base derives not only from accounting, but also from economics, industrial engineering, management science, social psychology and policy analysis.*

**RECOMMENDATION**

Efforts be made to enhance training of staff engaged in performance audit work to performance improvement tools and techniques, including process analysis, TQM, benchmarking and best practice.

**FINDING**

*The provisions of section 38B of the Public Finance and Audit Act 1983 have been interpreted by the Solicitor-General in a way that any audits undertaken that address efficiency, economy, effectiveness and/or compliance are considered to fall within the scope of section 38B. The effect of this interpretation is that anything that is not a financial audit is regarded as a special audit. This creates some major difficulties, the most important one of which is a presumption that performance audit is the same as a compliance audit. However, the methodology and approach of performance audit are fundamentally different to the methodologies and approaches to compliance/regularity audits.*

**RECOMMENDATION**

Performance Audit be defined in the Public Finance and Audit Act as relating to a review or examination of the economy and/or efficiency and/or effectiveness of practices, operations and service delivery arrangements of an agency.

References to Special Audit in section 38B be replaced by references to Performance Audit.

References to compliance be removed from section 38B. A new section of the Act be drafted to specify the roles, responsibilities and accountabilities of the Auditor-General in relation to compliance and regularity audit.

**FINDING**

*Parliamentary requests for the Auditor General to undertake “Special Audits” have indicated a preference for a direct audit approach - that is, detailed reports on specific topics. There is no systematic requirement, or request, for the Auditor-General to produce reports on performance statements and indicators.*

*The effect of Parliaments’ requirements has had the effect of concentrating resources in the area of direct reporting. The level of resources that goes into preparing direct audit reports is extensive.*

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**RECOMMENDATION**

The Act make specific provision for the Auditor-General to certify, or attest, that performance statements and indicators prepared by management are a relevant, reliable and fair representation of the economy, efficiency and effectiveness of an agency's management, operations and service delivery arrangements.

**FINDING**

*Under present arrangements funding for performance audit work is mainly provided through:*

- *a "levy" on financial audit work*
- *parliamentary appropriation*
- *specific "fee for service" arrangements".*

*The levy on financial audit work is in effect a "cross subsidy" from financial audit to performance audit. We regard this arrangement as inconsistent with the Government's objectives of identifying the full cost of service delivery and removing, to the maximum extent possible, cross subsidy arrangements in agencies.*

**RECOMMENDATION**

The cost of performance, compliance and regularity audit be met from either:

- *Parliamentary Appropriation; and*
- *Fee for service arrangements.*

**FINDING**

*The creation of an Audit Committee of the Parliament provides a formal link between the Parliament and the Auditor-General. It would provide a mechanism for the Auditor-General to obtain specific references from the parliament and for the Auditor-General to inform the Parliament of performance and compliance audit work that is to be undertaken. . . . we are of the view that the same functions can be performed by the Public Accounts Committee. We see the role as one of consultation and discussion rather than direction and oversight.*

*We also consider that the Public Accounts Committee should take a more active role in*

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*commenting on and monitoring the outcome of performance audit work. In some instances the Committee has held follow up hearings - but this is not a regular procedure.*

### **RECOMMENDATION**

The Public Accounts Committee adopt the following responsibilities in relation to the Auditor-General and the conduct of performance audit:

- review and discuss the annual and forward performance audit plan with the Auditor-General;
- recommend for Parliamentary approval the resources required to undertake the Audit Plan;
- review Performance Audit conclusions and recommendations following tabling in Parliament.

### **FINDING**

*An expectation of the Public Accounts Committee in 1993 for performance audits to focus more on effectiveness issues has also created difficulties to the extent that performance audit considerations of program effectiveness run a very high risk of touching on policy issues. Section 38B of the Act precludes the Auditor-General from commenting on the merits of government policy objectives. The Audit Office sought advice from the Crown Solicitor in 1993 to clarify the restriction on commenting on policy issues, and in 1994 a further legal opinion was obtained from the NSW Solicitor-General. Solutions need to be found to the problem of varying interpretations of the Public Finance and Audit Act 1983 with respect to performance audit work and its relation to policy.*

### **RECOMMENDATION**

In reporting on a performance audit, and without questioning the merits of policy objectives, the Auditor-General draw attention to areas where:-

- there is lack of clarity, ambiguity or inconsistency in policy goals and program objectives;
- assumed policies are not supported by documentation and evidence of the intention of Government and/or Ministers.

**FINDING**

*The Audit Office has commenced a process to refine [its operational] objectives in a form that is . . . amenable to performance assessment. It has carried out client surveys, has produced a strategy document reporting on the outcome of a strategy workshop undertaken in July 1994, and has held another strategy workshop in July 1995. Unfortunately the strategy document does not contain a clear indication of the way in which the goals of the Performance Audit branch are to be achieved and how the key issues it identified are to be addressed. Although there is excess of 60 "Actions Agreed Upon" contained in the strategy document, there is no indication of time frame, order of priority or the resources that will be required.*

**RECOMMENDATION**

The Performance Audit Branch prepare a Business Plan that clearly identifies:

- Current Mission;
- Goals and Objectives that are realistic and achievable over the short to medium term;
- Key business issues;
- The six or eight strategies to achieve goals and objectives;
- The resource implications;
- The performance indicators that will be used to report on achievement.

**FINDING**

*The Audit Office has demonstrated that it has developed the experience to address complex topics. Its work in the area of management practices and operational and service effectiveness should continue. As the knowledge and skill base of the Office expands, however, there will be the opportunity to move the focus of audit away from the traditional approach which suggests that all information for input into the audit process should come from a single study.*

**RECOMMENDATION**

The Audit Office adopt an integrated approach to audit that combines:

- review of financial and accounting systems;
- assessment and attestation of financial reports;
- consideration of arrangements to minimise risk;
- assessment of the overall performance of individual services (on a cyclical basis);
- assessment of the effectiveness of management arrangements;
- assessment and attestation of performance statements and indicators.

**FINDING**

*This approach to audit is best undertaken in an integrated management and organisational structure. The Audit Office has a long term strategy for integrating performance audit with financial audit. The Audit Office also has a strategy that at least 50 percent of the work of the Audit Office will be directed towards performance. This will require reallocation of resources, and careful planning and implementation.*

**RECOMMENDATION**

Strategies be put in place that will achieve integration of performance audit work with the finance audit branches over a period of three to five years.

**FINDING**

*In New South Wales there is a major opportunity for the Auditor-General to take a pro-active role in the development and implementation of attest audit in relation to performance measures and reports. [However,] the quality of performance indicators and measures that are currently available would not enable the Auditor-General to systematically report, or report meaningfully on performance. There still remains significant scope for the Auditor-General to develop approaches, in cooperation with the Treasury and other central agencies, for the attest audit of key activities and processes in government agencies.*

**RECOMMENDATION**

The Auditor-General work closely with the Parliament and the Central Agencies in developing a systematic approach for performance reporting in the NSW Budget Sector.

The Auditor-General be given responsibility for undertaking attest audits of Performance Statements prepared by agency management and reporting on the accuracy, relevance and reliability of performance indicators.

**FINDING**

*With the integration of financial and performance audit into the general operational areas of the Audit Office, there would still be a need for a separate organisational unit to:*

- *develop broad based, government wide audit criteria and best practice guides that could be used to guide in performance and financial audit work*
- *develop and monitor methodology on performance audit*
- *undertake large special reviews - in the nature of special projects of a compliance nature.*

**RECOMMENDATION**

The current Performance Audit Branch continue as a separate organisational unit with an ongoing responsibility for:

- undertaking broad based, sector wide performance audits with a view to developing audit criteria, benchmarks and best practice for use in performance audit work undertaken in operational areas;
- developing the Office's methodology for audit of performance statements;
- maintenance of performance audit manuals;
- undertaking performance and related compliance and regularity audit work that does not fit easily within the client service focus and responsibilities of finance-performance audit branches.

**FINDING**

*Once an audit report is produced for the Public Accounts Committee and copies given to the agency, there appears to be little follow up.*

**RECOMMENDATION**

The Public Accounts Committee have a specific responsibility for review of Audit Office findings and conclusions and making recommendations to Government.

The Government be required to respond to Public Accounts Committee reports within a six month time frame.



## G. COMPLIANCE AUDITING

### FINDING

*Compliance auditing (that is, the audit of how well an agency has complied with all the rules and regulations it should comply with, including legislation, regulations, guidelines and contractual obligations) has been identified as a critical weakness in the audit process. At present, the only reference in the legislation to compliance auditing is in respect of special audits. However, it is also a significant part of comprehensive financial auditing.*

Compliance is a natural subset to any auditing activity, and there is no need for the legislation to circumscribe, as it currently seems to do, the scope of any audits. Current interpretations of the legislation appear to limit the Auditor-General's ability to carry out compliance auditing outside the conduct of performance auditing.

### FINDING

*In respect of compliance auditing, there appears to be an expectation gap between what the Parliament and the public expect of the Auditor-General and the extent of the Auditor-General's powers to undertake and report on such matters.*

### RECOMMENDATION 20

The legislation should be amended to ensure that the Auditor-General's mandate includes a specific power to undertake compliance auditing as part of his regular audit function, and to enable the Auditor-General to report directly to the Parliament on compliance matters.

## H. BENCHMARKING

The Panel has identified benchmarking as an essential management tool. While the consultants were asked to identify benchmarks applicable to the public sector the panel was disappointed that the consultants failed to adequately address this issue. Late in the review the Panel became aware that the Auditor-General, in conjunction with the Auditor-General for Western Australia were in the process of developing benchmarking measures for Australian area public Audit Offices.

The Review Panel noted that a public audit office operating with a statutory audit mandate is not directly exposed to the open market and related competitive market discipline compared to other areas of professional audit practice. The Auditor-General of NSW should be commended for his initiative in benchmarking his own operations.

**FINDING**

*The Panel found that the development and inclusion of benchmarking data in the Audit Office Annual Report to be a most positive development in accountability. However the Panel agreed that the ongoing development of benchmarking data including comparisons with other public audit offices in Australia is essential.*

**RECOMMENDATION 21**

The Auditor-General should continue to develop appropriate benchmarks for inclusion in his annual report as well as for internal management purposes. Benchmarks included in the annual report should be subject to external scrutiny in the form of an audit opinion signed by the independent external auditor.

**3. INDIVIDUAL CONSULTANTS'  
REPORTS:**

**FINDINGS  
AND  
RECOMMENDATIONS**

The following summary findings and recommendations have been extracted from the reports of individual consultants. They should be read in conjunction with the full reports, which can be found in Volume 2 and 3.

**A. TOM SHERIDAN, REVIEW COORDINATOR**  
**INDEPENDENCE: MANDATE: MISSION**

**FINDING**

*The independence and mandate of the NSW Auditor-General is being frustrated (if not thwarted) by:-*

- (a) *legislation that is ambiguous, too prescriptive and which enables access to information critical to the audit process to be restricted;*
- (b) *a wide interpretation by agencies as to what constitutes government policy objectives on matters the Auditor-General wishes to audit.*

**RECOMMENDATION**

That legislation be amended to provide the Auditor-General with the:-

(a) discretion to determine the degree of emphasis to be given to economy, efficiency and effectiveness in the audit of a particular activity;

(b) mandate to audit activities (or projects) that have terminated.

**FINDING**

*Compliance with laws, regulations, standards of control and general probity and propriety of public sector management is a fundamental requirement of public sector auditing.*

*The inability to undertake compliance audits, beyond that required for a financial attest audit, is a critical weakness in the audit process of the NSW Audit Office.*

**RECOMMENDATION**

That:-

(a) reference to compliance remain in section 38B of the Public Finance and Audit Act 1933;

(b) legislation provide for the scope of financial audits conducted by the Auditor-General for all audit clients, to be extended to incorporate an audit of compliance with all relevant laws, regulations, instructions etc.

**FINDING**

*It is universally accepted and is a fundamental tenet of the accountability process of the Westminster System that Auditors-General:-*

(a) *have no mandate to review and report on government policy objectives;*

(b) *do have a mandate to review and report on the economy, efficiency and operational effectiveness of the delivery of government policy objectives, including whether the policy is achieving its stated objectives.*

*The distinction between government policy objectives and delivery of government policy can often be blurred and creates opportunity for governments and their agencies to cry “policy” if they believe the Auditor-General is moving into areas where they may not be entirely comfortable.*

*Legislation which is simple, clear and straightforward; which recognises the two basic elements of public sector auditing (financial/compliance: performance); extends the financial audit to include compliance that has regard to the integrity of public sector operations; and provides for government policy boundaries to be confirmed before a performance audit is commenced, should be implemented as a matter of priority.*

**RECOMMENDATION**

Legislation provide that:-

(a) before a performance audit is commenced, the Minister responsible be requested by the Auditor-General to provide to him within a specified time, a written statement of the policy relating to the programme or activity which is to be the subject of the performance audit;

(b) if the Minister, provides a statement of policy, which the Auditor-General considers restricts the accountability process, then the Auditor-General is to report the matter to the Parliament and seek direction.

© if the Minister does not provide a statement of policy within the specified time, the Auditor-General is to report to the Parliament the absence of a policy for the programme or activity.

**RECOMMENDATION**

That section 63B of the Public Finance and Audit Act, 1983 be amended to include all entities established by a statutory body or a department.

That legislation be enacted to ensure that the Auditor-General has access to Cabinet submissions (including supporting documents etc) and Cabinet decisions; and to documents based on legal professional privilege which the Auditor-General considers relevant to the proper discharge of his/her statutory responsibilities.

That present legislation:-

(a) be simplified to recognise the 2 basic elements of public sector auditing rather than the component parts, with clear, simple and unambiguous reporting requirements with respect to each element;

(b) be amended to provide for the Auditor-General's reports to Parliament to be tabled simultaneously in both the Legislative Assembly and the Legislative Council.

**FINDING**

*While Executive Government must have final responsibility for the allocation of funds, it*

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*would be more appropriate if they were advised on the question of the Auditor-Generals' resources, by a Committee appointed by the Parliament rather than an audit client of the Auditor-General (Treasury).*

## **RECOMMENDATION**

That:-

(a) the Auditor-General continue to charge and retain the audit fee for all financial and compliance audits for which he/she has a statutory responsibility to undertake;

(b) the present arrangement whereby performance audit is financed, in part, by a loading on the annual financial audit, be continued;

(c) Treasury have the right to recover to Consolidated Fund, the cost of a performance audit, from an audit client where appropriate;

(d) Parliament appoint either the PAC or a small independent and non-public sector Advisory Committee (with business and financial experience) to advise the Parliament on the Auditor-General's performance and resources.

That:-

(a) constituting the Auditor-General's Office as a body corporate, free of central government agency control, be supported by the PAC and the Parliament;

(b) the Auditor-General consider widening the Mission of the Office, to embrace an overall and more outward public sector management vision as well as an audit and accountability vision.

## **CONCLUDING**

The Performance Audit Branch has achieved a number of positive results in its short history. It has also attracted criticism from one or two agencies, where it has been claimed that the audit intruded into matters of government policy.

On balance there is much to be positive about. On the other hand the costs of performance audits are high. Even the supporters of performance audit and the Auditor-General's role in that function, are critical of the costs.

Evidence provided by the Auditor-General to Coopers & Lybrand provides no credible comparison of the relevant costs of performance audits, viz a viz other Australian and overseas Audit Offices.

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The present arrangement of a separate Performance Audit Branch is not conducive to the economic, efficient and effective conduct of all performance audits. It creates:-

- (a) a process in which staff search for criteria to justify an audit of a subject which has only been broadly defined (or hypothesised). In some instances terms of reference are not established until some 3 months into the audit;
- (b) a process which is time consuming and costly. The average cost of a performance audit is in excess of \$200,000 with some audits taking up to 10 months to complete;
- (c) a management style that is seen as threatening, gives the impression of a “fishing expedition” and gives the performance audit a higher profile than is either necessary or desirable.

It is essential for a much stronger and formal relationship to be established between financial and compliance audit and performance audit. Current problems could be largely overcome by:-

- (a) pooling the resources of the Performance Audit Branch into the Financial Audit Branches and through knowledge gained from the normal financial and compliance audit, staff would be better placed to more easily identify appropriate performance audits;
- (b) retaining a small nucleus of staff in the Performance Audit Branch to work with agency management on across public sector studies and to provide technical advice.

**RECOMMENDATION**

That:-

(a) the staff of the Performance Audit Branch be progressively pooled into the Financial Audit Branches within the next 2 years;

(b) a small nucleus of staff be retained in the existing Performance Audit Branch to undertake-

- broad sector or government wide studies to identify audit criteria, benchmarks and best practice with a view to preparing and disseminating audit guides;
- development of methodologies and approaches, particularly in relation to attest audit of performance statements and indicators.

**FINDING**

*Greater emphasis should be given to performance audits that concentrate on economy, efficiency and operational effectiveness (rather than program effectiveness) as they are likely to more readily provide tangible benefits to the taxpayer.*

**RECOMMENDATION**

Greater emphasis be given to performance audits, based on economy, efficiency and operational effectiveness, that have the potential to produce tangible benefits to the taxpayer.

**FINDING**

*The Public Accounts Committee, as the Audit Committee of the Parliament, should undertake a more active role in following up issues raised by the Auditor-General.*

**RECOMMENDATION**

That:-

(a) the Public Accounts Committee ensure that matters raised by the Auditor-General in his reports to Parliament are addressed adequately and promptly by the Government and its agencies;

(b) the capacity of the PAC Secretariat to undertake the additional work arising out of (a) above, be examined as a matter of priority.

**FINDING**

The provision of additional audit services, beyond the normal financial and compliance audit service is now an accepted part of contemporary audit. It adds value to the audit and does much to dispel the notion that an auditor is only interested in the past. The expanded role of the Auditor-General in this area should be encouraged and supported.

**RECOMMENDATION**

That:-

(a) the Auditor-General's role in providing additional audit services be encouraged and supported;

(b) the Auditor-General should ensure that his/her independence is not compromised by any additional audit services he/she provides.

## **B. *PRICE WATERHOUSE*** **MANAGEMENT OF THE AUDIT FUNCTION**

### **GENERAL**

The overall conclusions to be drawn from the review are that the Audit Office has made great strides in identifying what is best practice and has plans and strategies in place for the future. The key issues, however, revolve around the actual implementation and monitoring of the plans and strategies

There is an obvious and quiet apparent focus on change in the Audit Office and this is being embraced by the majority of the staff. It is important that the momentum be maintained in a realistic way so that targets and deadlines become challenging but not unachievable.

### **EFFECTIVENESS OF ORGANISATIONAL STAFFING STRUCTURE**

#### **FINDING**

- *There is a need to finalise and put in place the new performance reporting system so that branch leaders can manage and control their resources more effectively.*
- *Determining the optimum staff mixed needs to be considered in the context of long term staff plan.*
- *The action plan that was developed from the Waite Consulting review of the support functions of the Audit Office should be reviewed and monitored by the Board of Management on a regular basis.*
- *Opportunities to transfer and rotate staff between branches and specialisations should be pursued with the aim of developing and enhancing the skills of all staff.*

## RECOMMENDATIONS

The new performance reporting system should be finalised and implemented as a high priority. Timely completion will enable the Branch AAG's to more effectively manage the resources under their control.

There should be a long term staff plan to bring the Office staff profile in line with a determined optimum staff mix. This will entail using and updating the Benchmark Matrix on a regular basis and linking it more closely to the planning and budgeting processes.

A plan should be developed to more closely integrate the attest audit and CIS Audit function in the longer term.

Opportunities to rotate attest and performance audit staff should be further considered. (Refer section 6 of our Review of the Management of Human Resources.) This will enable efficient use of staff resources and will enhance and broaden the skill base of the staff involved.

The leaders of industry specialisation groups should instigate specific action plans involving both staff and clients in developing specialist skills. PRM branch has a key role in identifying appropriate training courses for each of the industry specialisation groups.

## ADEQUACY AND EFFECTIVENESS OF THE PLANNING PROCESS

### FINDING

- *The Benchmark Matrix Study provides useful guidance for projecting future staff needs and should be linked to the staff scheduling and staff allocation systems.*
- *A longer term plan (5 to 10 years), incorporating an optimal staff pyramid and how to get there, is required. The plan needs to incorporate issues such as expected growth rates in client hours, utilisation rates, staff retention rates, and whether to grow the staff from within or to recruit externally.*
- *The implementation and monitoring of the staff scheduling system should be a high priority.*

## **RECOMMENDATIONS**

The best practices identified in the Benchmark Matrix noted above should form an integral part of the planning and scheduling process.

The completion and integration of Winstaff with the office management systems should be a high priority.

Consideration should be given to completing the Office Budget before the commencement of the financial year.

A longer term plan for the Audit Office should be developed including consideration of:

- succession planning on key assignments and key responsibilities
- the staff pyramid now and in the future
- whether to build up technical skills in-house or out source
- contracted out activities.

## **ADEQUACY AND EFFECTIVENESS OF SYSTEMS TO MEASURE AND CONTROL PRODUCTIVITY**

### **FINDING**

- *The new management reporting systems are now being introduced. The previous reporting systems were inadequate and ineffective in monitoring and controlling performance.*
- *There is a need for improved communications between audit support services and the audit groups. This includes greater “user” involvement in systems and programming development.*
- *There is no incentive for staff (including senior personnel) to record all the hours worked on audit assignments. Resource planning can only be effective if all personnel record the necessary hours to complete each audit.*

**RECOMMENDATIONS**

The current attitude and momentum towards client service should be encouraged and maintained.

Non performing staff should be actively managed by supervisors setting objectives, regularly monitoring performance and providing regular feedback through a counselling and appraisal process.

**MANAGEMENT CULTURE - EFFECT ON PERFORMANCE****FINDING**

- *The change culture within the Audit Office is happening and there is momentum.*
- *The inability to effectively deal with non performing staff is seen as a significant issue within the Audit Office. Their presence can have a negative effect on other talented employees and this needs to be carefully handled*

THERE ARE NO RECOMMENDATIONS

**RELATIONSHIP WITH CLIENTS AND INFLUENCING FACTORS****FINDING**

- *Clients of the Audit Office have commented favourably on the changes and the focus on improving client relationships. The thrust for continuous improvement in client service should be encouraged and maintained.*
- *Client satisfaction surveys over the past 3 years and interviews with selected clients show that encouraging changes have occurred. However the perceived improvements in performance have not yet been reflected by improvements in the Client Satisfaction Index.*

- *The Audit Offices role with the Parliament would be facilitated by the appointment of an audit committee of the Parliament. This would seem to be an appropriate role for the Public Accounts Committee.*

THERE ARE NO RECOMMENDATIONS

## **EXTENT OF BEST PRACTICES IN MANAGEMENT**

### **FINDING**

- *The Audit Office has a clear understanding of what are best practices in managing an audit business. It has access to the Big 6's ideas, methodologies, and benchmarks. The key issue is implementing and monitoring the use of these practices. In a period of great change as has occurred over the past 3 years, there is a need to reflect on the pace of such change and to ensure that procedures are in place to actually make things happen.*
- *A variety of consultants have been engaged to review and report on various aspects of Audit Office activities. Where their recommendations have been agreed to by the Audit Office, they need to be actively pursued and monitored.*

### **RECOMMENDATION**

Management procedures should include designated responsibility for the implementation of best practice ideas. This requires ongoing accountability for projects such as:

- The financial management system
- Quality accreditation
- Industry specialisation
- Improving office support service

The various recommendations put forward by the various consultants to the Audit Office should continue to be actively pursued and monitored.



## C. ***PRICE WATERHOUSE*** **MANAGEMENT OF HUMAN RESOURCES**

### **GENERAL**

There is recognition in the AO of the role within and results provided to the Office at the operational level by skilled and experienced human resources professionals. However, there is yet to be full appreciation as to how HR management expertise may benefit the AO at a strategic level.

The integration of the HR management function with the process of corporate planning in the AO, together with a need to upgrade and enhance current HR procedures and practices, represent the major issues emanating from this review.

### **RECRUITMENT AND SELECTION**

#### **FINDING**

- *Recruitment criteria are a fundamental part of the recruitment process used in the AO. Such criteria should reflect the attributes required in applicants which are relevant to the culture envisioned for the AO.*
- *The AO, in recent times, has been successful in attracting to it, quality recruits, particularly at graduate level. To maintain or improve this standard, recruitment and selection processes for both graduates and higher level entry employees should be enhanced to ensure quality applicants are selected.*

## RECOMMENDATIONS

Appropriate personal attributes associated with building the AO's defined culture to be prominently incorporated into all job descriptions for positions in the AO. Those on Selection Committees to be suitably trained to assess and evaluate these attributes.

Graduate recruitment process to be upgraded and enhanced by the application of more resources and materials e.g., higher quality brochures and information material, more time available to dedicate to career fairs etc., enhanced visits to the AO for interviews.

Minimum quality criteria to be established for graduate recruits.

Standards and procedures to be established for Work Reports prepared for Selection Committees. Production of "honest" Work Reports to be a requirement.

Performance standards to be established in relation to timeliness etc for the recruitment of replacement staff.

Selection Committee members to be carefully screened and selected to ensure they possess the required characteristics to make recruitment decisions.

Continuity of Selection Committee membership to be maintained to achieve some consistency in selection decisions. Also, Selection Committee members to be from the same branch in which the vacancy exists.

High level interviews (by SES staff in the branch where the vacancy exists) to be conducted to confirm Selection Committee decisions.

Selective testing of applicants eg: tests of conceptual reasoning, critical analysis etc. to be used to assist in evaluating how applicants will perform at the level for which they are being recruited.

## TRAINING AND DEVELOPMENT

### FINDING

- *To be proactive and to better support the achievement of the AO Corporate Goals, it is seen as necessary that the Training and Development (T&D) function establish formalised links into the planning process and with other functions within the AO.*

- *T&D systems, administration and analysis of the function could be improved to make the function more effective and capable of evaluation.*
- *HR management and T&D are complementary functions and therefore the links between these areas needs to be strong.*
- *Currently, far greater emphasis in the T&D function is placed on technical compared with managerial training. Managerial and personal development training are part of the processes needed in an organisation undergoing significant change.*

## RECOMMENDATIONS

Best practice organisations have a strong link between their Training Plan and Business Plan. A formally documented link needs to be created between the business plan objectives and training responses. This will enable the PD Unit to be more proactive and ensure that the content of training programs and the methodology used are linked to the business plans of the AO and support the Corporate Goals of the Office. Input from PD unit should be considered at the business planning stage.

To ensure that the activities of the training function reflect and support the latest practice of other functions (audit methods, technical products etc), formally organised links should be established between the PD unit and other functions within the AO.

The short, medium and long term objectives of the training function to be clearly defined in writing and confirmed as appropriate by the AO leadership. This is to be reviewed and updated on a regular basis.

To ensure that training is only used where it is likely to be cost effective, the AO should give careful consideration to the cost/benefit of all training activities. It is expected that the training module of the recently purchased CHRIS software will facilitate the administration and greater depth of analysis of the training function.

As mentioned elsewhere in this report training is one area that could act as a critical success factor to recruiting and retaining staff. Consideration should be given to including the PD unit in the development of recruitment, career development and retention initiatives.

To ensure that training effort is directed toward priority areas for the AO, is relevant and cost effective, it is vital to conduct training needs analyses on a continuing basis.

Change management efforts derived from the HR function should involve the PD unit to ensure that suitable changes are made to the training program. Similarly, the HR function should have access to all training information, so that they can take the appropriate actions to support and reflect the training.

An increase in managerial personal skills training for managerial staff is recommended in other areas of this report to improve HR management, and will also facilitate the change process taking place in the AO.

Consideration should be given to investment in the resources to develop CBT (Computer Based Training) materials/remove learning facilities for courses that are of particular importance to on-the-job performance. [Note: Remove learning would marginalise the benefits of trainees meeting with other members of the AO at classroom training sessions, but would still be of more benefit than no training at all.]

Mechanisms should be enhanced to provide feedback to managers after training courses, and to assess the effectiveness of training on-the-job. Debriefing sessions and client feedback could then form the basis of amendments to current training programs, or could define a need for additional training to improve service delivery to clients.

The PD unit should be adequately resourced and supported by the other branches to design and develop courseware that is current, relevant and aligned to the Corporate Goals of the AO. There should be no barriers to the allocation of field staff to assist the PD unit.

Over time, it is planned that the AO be less reliant during busy periods or temporary staff. Subject to success in this area, resources need to be allocated to the training of temporary staff to a level which does not potentially compromise standards of auditing and related services provided to clients.

As identified by the report of Waite Consulting in April 1995, there is a need to supplement the training records now kept by the Acorn system. At the earliest opportunity, an assessment needs to be made of CHRIS, the software that has been selected for the HR functions within the AO to determine whether this software will address the needs of the PD unit and where tailoring of this software may be necessary.

## **PERFORMANCE MANAGEMENT**

### **FINDING**

- *As the culture of the AO is changing so are the performance management needs of the Office. Accurate and relevant information on the performance of staff is required to effectively manage the practice, and for individual personal development. Appropriate systems needs to be in place to provide this information.*
- *Management is aware of and is attempting to address the issue of under performing staff. The aim of current and additional procedures and processes needs to be successful resolution of this issues.*

## RECOMMENDATIONS

Changes and enhancements to the Performance Management System need to be implemented in such a way so that individual differences in performance may be clearly identifiable, and so that management may evaluate global strengths and weaknesses in an objective and empirical manner.

A program needs to be put in place to develop competency based position descriptions for all levels of staff in the AO. [Work has already commenced on a competency model/skills matrix for staff in IS Audit (although this does not conform to current Public Service of NSW guidelines), and “Position Profits” have been developed for attest audit staff, although these are not competency based]. [If this recommendation is adopted, there would be significant implications in the area of Training and Development].

Appropriate performance criteria for all levels of staff need to be developed as the basis for the performance management system. These criteria would be derived from the competencies which constitute the position descriptions. [Work has commenced on appropriate performance indicators and work standards for staff in the Performance Audit Branch]

A cultural change program is required to overcome the reluctance to assess staff “honestly”. This could be part of any ongoing training and development being provided on performance management. In this context, the completion of “Work Reports” needs to be covered with a view to improving the quality of these reports so that they accurately reflect abilities, skills and knowledge.

Where staff have been promoted to a particular grade level but it is assessed that they are unable to operate at that level, in line with the recent “Action Team” recommendations, an intensive individually based program need to be put in place for each person to attempt to bring these staff to the required level of performance, or to consider other courses of action. An SES person in each branch needs to take ownership for such a program.

In each branch, in conjunction with the program outlined above for those promoted to a level at which they cannot presently operate, a program needs to be in place to address the issue of under performing staff, who are so, not solely because they have been promoted beyond their level of competence, with a view to completing the required individual action plans within a specified time frame. Once again, an SES person needs to take ownership of such a program.

Mechanisms need to be considered so that appropriate historical performance information may be incorporated into decisions relating to promotions, and “broad banding” as envisaged in the Enterprise Agreement may facilitate this to some extent. The aim should be that the best performers are promoted first.

## **CAREER DEVELOPMENT**

### **FINDING**

- *At present, career development is not an active part of the management of HR in the AO. A program of career development jointly managed by line and HR management could greatly assist staff motivation and the process of change in the AO.*
- *The knowledge and experience of senior staff in the AO has not been applied to provide career guidance for less senior staff in the office. Many benefits could be provided to the AO by the introduction of a formal counselling program, mentoring and moves towards a coaching culture.*
- *Integration of a number of HR initiatives should be considered in the establishment of a program of career development. In this context, job rotation, transfers and secondments will be an important part of the program.*

## RECOMMENDATIONS

“Career Development” needs to become a joint responsibility of branch management and human resources management in the AO to assist the process of change in the Office, and to maintain the motivation of good employees the AO wishes to retain. Ownership and responsibility for career development must be assigned and an active program put in place to assist all staff to manage their careers.

Counselling of all staff should be introduced to give staff a formal opportunity to discuss their careers with a senior person in the AO. Training in counselling techniques would be necessary for those given the responsibility for counselling. The detailed report sets out on page 25 a recommended counselling program.

As part of the career development process, consideration should be given to more regular rotation on jobs according to individual development needs. Also, more inter-branch secondments or transfers (between attest audit and IS audit and performance audit and vice versa as appropriate) should be facilitated. The AO should investigate in detail the opportunities for staff to be seconded to other AO’s in other States, New Zealand and overseas countries, as well as secondments to comparably large private chartered accounting firms, clients and other organisations.

Those in managerial positions require training and guidance in the subject of career development, with a view to developing a culture where “mentoring” becomes commonplace. Training for all SES Staff and Senior Managers in the coaching and management of staff is envisaged.

## CORPORATE CULTURE

### FINDING

- *For a process of cultural change to be successful, it is best practice to closely involve and invite participation from HR professionals.*
- *To assess progress in the process of cultural change, a program of regular staff surveys would be the ideal monitor and measure.*



**RECOMMENDATIONS**

Some of the proposals contained with the Enterprise Agreement will address some of the remuneration issues in part. Effort must be applied to bring the Enterprise Agreement into place.

Once the Enterprise Agreement is in place it could be the foundation for any further initiatives to not have the AO within the scope of the Public Sector Management Act.

Although Public Sector requirements or guidelines may ultimately prevent it, further research and action should be taken to determine the extent to which current salary bands could be improved by wider application of specialist/skills shortages allowances and by job re-evaluation according to the recognised methodology.

As remuneration is unlikely by itself to be a means by which staff can be retained in the AO, recognition must be given by AO management to the importance of a co-ordinate program for staff retention. Such a program would require top management support and a recommended program is set out in Section 9 of this report.

Market levels of remuneration need to be regularly monitored and compared to the levels of remuneration in the AO to understand fully current relativities and levels where AO staff are most "at risk". Consideration needs to be given to the fact that IS audit and performance audit staff have different skills sets and expertise and their remuneration should not necessarily be aligned to the attest audit staff.

## REMUNERATION AND BENEFITS

### FINDING

- *The Public Sector Management Act limits the amount of flexibility available to the AO in the area of remuneration and benefits. This is an area where the AO must compete on the open market. The Enterprise Agreement, as currently drafted, will address some remuneration and benefits issues, but the AO will still be restricted in its ability to react to the marketplace.*

THERE ARE NO RECOMMENDATIONS
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## STAFFING

### FINDING

- *Adequately staffing the AO means knowing the precise requirements of the Office and being able to respond in an appropriate timeframe to meet those requirements. Systems and procedures need to be in place to enable the AO to respond appropriately.*
- *Turnover, particularly of well performed staff, will prevent the AO being able to achieve its Corporate Goals. Introduction of a Co-ordinated Staff Retention Program should go a long way towards addressing the issue of turnover.*

## **RECOMMENDATIONS**

The staffing requirement of the AO is not static. As such it is incumbent upon the management of the AO that they have in place procedures and mechanisms to define current and future requirements. The Benchmark/Matrix methodology needs to be applied to this task and needs to be enhanced according to changed or expanded needs. Those in managerial positions need to be able to clearly articulate their staff needs in terms of skills, abilities and knowledge which will vary according to the Office's Corporate Goals.

As mentioned in other parts of this report and in other reports, every effort should be applied to eliminate features of staffing of the AO such as underperforming staff and excessive use of temporary staff, which reduce productivity and distract managerial time and effort.

Turnover and other aspects of human resources management to be addressed by the introduction of a "Co-ordinated Staff Retention Program". The detailed report sets out on page 40 a recommended co-ordinated staff retention program.

## **HUMAN RESOURCES MANAGEMENT CAPABILITIES**

### **FINDING**

- *Recommendations in this report suggest the need for more resources in the HR function, possibly at a more senior level than current staffing, to implement the required new HR initiatives and to maintain the momentum of change already established.*

**RECOMMENDATIONS**

Because of the nature of the AO, the achievement of Corporate Goals will be entirely dependent upon the employees. Therefore there needs to be HR and T&D involvement in the planning phases of setting corporate goals and other strategic planning.

Many of the recommendations in this report are considered to be initiatives which will further support the process of change already commenced in the AO. It is felt additional HR and T&D resources will be required in the AO to implement the recommendations made and to maintain momentum for the process already begun.

Subject to an appropriate evaluation of current internal resources, it is recommended that consideration be given to appointment of an HR/T&D Director who would have the skills and experience to implement many of the recommendations of this report and who would be at a sufficiently high level in the AO to participate in the strategic planning and corporate goal setting processes. Such an individual could also “strive” those HR initiatives which have been delegated to line management.

**D.ERNST & YOUNG**  
CONDUCT OF FINANCIAL AUDITS

## CONFIDENCE LEVELS

### FINDING

*The use of a 95% confidence level by the Audit Office contrasts with contemporary audit practices. The majority of the major Accounting Firms are moving away from this benchmark and placing a greater emphasis on the informed exercise of professional judgement in reaching audit conclusions, taking into account an assessment of risk, materiality and nature of the account under review; the practicality and efficiency of applying DST with a 95% confidence level for a large department. To achieve this degree of assurance, a high volume of transactions may need to be tested by the Audit Office*

### RECOMMENDATION

That the Audit Office review existing practices for determining acceptable confidence levels against the background of developments in the large Accounting Firms, so as to promote effective exercise of audit judgement and efficient audit conduct.

## INHERENT RISK

### FINDING

*Whilst it is essential that a sufficient risk assessment is carried out for all significant account areas, there is a question whether current Audit Office procedures are being applied more extensively than is needed, taking into account:*

- *the impact on the overall efficiency of the financial audit including the documentation of risk assessments; and*
- *the ensuing benefits arising from this risk analysis, particularly for low risk account areas*

### RECOMMENDATION

That the Audit Office pursue as a priority its stated intention to recommend to the Auditor-General that inherent risk assessments be limited to significant account areas. In formulating its revised policy, the Audit Office should note the following: Inherent risk assessments should be performed for significant account areas taking into account the related business and audit risk of the client.

## **REQUIRED REVIEW PROCESSES FOR DELEGATED WORK**

### **FINDING**

*Audit Office procedures required that work delegated to assistants be reviewed by supervisors. In addition, the Engagement controller and Audit Manager are required to review the planning documents and all supporting workpapers. The Engagement Reviewer is required to perform a high level review of the overall results.*

*We understand that the review by the Engagement Reviewer has not always been performed.*

### **RECOMMENDATION**

That the Audit Office strengthen its processes for ensuring that required review processes and their complete documentation be undertaken in accordance with Audit Office Guidelines.

## **PLANNING PROCESSES**

### **FINDING**

*We noted a lack of audit planning meetings involving client and engagement staff. We do note, however, that regular contact is maintained by the Audit Office with clients, particularly on larger assignments, which ensures that relevant issues and business developments are communicated in a timely manner.*

*Our review indicated that relevant accounting and auditing issues were properly addressed during the conduct of the audit. However we believe that more emphasis should be placed on documenting and reporting significant accounting and auditing issues. The Audit Plan should summarise these issues, together with the recommended accounting treatment where appropriate. In addition, consideration should be given to reporting the issues identified to the client in a closing report at the conclusion of the audit.*

*Consideration should also be given to incorporating value adding initiatives in the overall planning process. These could include identifying client and stakeholder needs and critical success factors; gathering information on the client business and industry; performing a SWOT analysis; and identifying other opportunities to add value out of the audit process*

**RECOMMENDATION**

That the Audit Office upgrade its planning processes to take account of the review observations in relation to:

- planning meetings;
- documentation of significant accounting and auditing issues; and
- identifying value adding initiatives

**COMPLIANCE REQUIREMENTS****FINDING**

*The Audit Office advised that its Guidelines required auditors to give due consideration to the primary legislation of the client. As well, there is a comprehensive section of the Guidelines which sets out how auditors should approach the matter of compliance/regularity on an audit. However, the Audit Office agreed that extension of the mandate can be proposed. This is consistent with the comment in the 1994 Report to Parliament, Volume 2, pages 39-42 where the Auditor-General said that compliance work undertaken as part of the financial audit “might not be as expansive as Parliament or the public assumes”.*

**RECOMMENDATION**

That Audit Office audit documentation identify the need to consider compliance requirements associated with all legislation relevant to the audit.

**IMPLEMENTATION OF POLICY IN CLIENT SERVICE REPORTS****FINDING**

*Audit Office Policy Statement 95/19 of 22 August 1995 established as policy the use of a Client Service Report to improve communications between the Audit Office and clients on the results of audit and major matters impacting on the audit approach, findings and value added areas. This policy was established following a recommendation of the internal 1994-95 Methodology and Quality Assurance Task Force Team.*

*The Review notes that it will be important for the Audit Office to closely monitor the effective implementation of the revised policy.*

**RECOMMENDATION**

That the Audit Office ensure that effective processes are applied in implementing its Policy Statement 95/19 on the use of Client Service Reports, to ensure full client value is delivered.

**USE OF INTERNAL AUDIT****FINDING**

*The use of internal audit is specifically addressed in the Office's methodology and our review of the files and discussions with a number of Engagement Controllers/ Audit Managers indicate that staff are placing reliance on internal audit where appropriate.*

*The Audit Office recognises the efficiency gains available from the closest liaison with agency internal audit units. Amongst steps taken to improve liaison has been the introduction of training courses for internal auditors.*

**RECOMMENDATION**

That the Audit Office seek to increase its liaison with agency internal audit groups to ensure maximum coordination between respective audit programs, and overall, greatest value for money to clients.

**QUALITY CONTROL OF AUDIT OFFICE STAFF AND CONTRACT AUDITORS****FINDING**

*A Quality Audit Review Committee was established in July 1992. The Review concluded that the quality assurance process, as observed in practice was limited to a review of compliance with existing Audit Office procedures.*

*While this compliance focus is itself an essential component of an effective audit operation, it does not achieve all the objects of a comprehensive quality assurance process. In particular, the stated aim of QARC does not include a role of providing an ongoing strategic re-assessment of practices with a view to continuous improvement.*

*The Audit Office advised that Audit Policy Statement 95/17 of 11 August 1995 established revised (and broadened) objectives for QARC covering the need identified by the Review for QARC processes to address issues associated with ongoing improvements in audit efficiency and effectiveness. The Review agrees with the broadening of the QARC role as expressed in Statement 95/17. Fundamental to its effectiveness in practice, however, will be how well best*

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*practices and improvements are converted into guidance and communicated to all audit staff. The Audit Office should ensure this occurs.*

**RECOMMENDATION**

That 'best practice' outcomes of Quality Audit Review Committee reviews be presented to all levels of staff to best promote continuous improvement.

**ADDING VALUE TO THE FINANCIAL AUDIT PROCESS****FINDING**

*The Audit Office has advised that the need for value adding initiatives is included in the Client Service Plan, subject to the constraints on ability to provide these initiatives under existing legislation based on a Crown Solicitor's opinion.*

*In our view, value adding initiatives need to be taken as part of the audit process itself. These would not be in the nature of special, additional accounting services, but rather would represent more effective auditing.*

**RECOMMENDATION**

That the Audit Office initiate changes to its audit methodology to enable a stronger focus to be placed in the audit process on value adding by better understanding client business needs and addressing key business issues.

## **ADOPTION OF CONTINUOUS AUDIT**

### **FINDING**

*We believe that it is timely for the Audit Office to begin development work directed to moving to a continuous audit process in the conduct of financial audits. In adopting this forward looking approach, the Audit Office will be maintaining itself within the leading area of best financial audit practice, with benefits to clients and taxpayers.*

### **RECOMMENDATION**

That the Audit Office initiate research into the adoption of a continuous audit approach to its financial auditing.

## **F. COOPERS & LYBRAND PERFORMANCE AUDITS**

### **FINDING**

*While accounting standards, legislation and academic literature are unequivocal about the concerns of performance audit with matters of economy, efficiency and effectiveness, guidance contained in the academic and professional literature about the subject matter, and the methodology, of performance audit varies considerably.*

### **RECOMMENDATION**

The work of the Auditor-General in the area of performance audit have a focus on:

- economy, efficiency and effectiveness of agency management practices, operations and service delivery - developing and applying “criteria based” audit methodologies;
- broad sector or government wide studies to identify audit criteria, benchmarks and best practice that have general application for use in direct audit assignments across particular agencies;
- development of frameworks and the auditing of the accuracy and relevance of performance statements prepared by agencies (attest audit);
- auditing of performance statements and indicators contained in performance statements as to validity, relevance and accuracy.

### **FINDING**

*There is no academic qualification in “performance audit”. The discipline base derives not only from accounting, but also from economics, industrial engineering, management science, social psychology and policy analysis.*

**RECOMMENDATION**

Efforts be made to enhance training of staff engaged in performance audit work to performance improvement tools and techniques, including process analysis, TQM, benchmarking and best practice.

**FINDING**

*The provisions of section 38B of the Public Finance and Audit Act 1983 have been interpreted by the Solicitor-General in a way that any audits undertaken that address efficiency, economy, effectiveness and/or compliance are considered to fall within the scope of section 38B. The effect of this interpretation is that anything that is not a financial audit is regarded as a special audit. This creates some major difficulties, the most important one of which is a presumption that performance audit is the same as a compliance audit. However, the methodology and approach of performance audit are fundamentally different to the methodologies and approaches to compliance/regularity audits.*

**RECOMMENDATION**

Performance Audit be defined in the Public Finance and Audit Act as relating to a review or examination of the economy and/or efficiency and/or effectiveness of practices, operations and service delivery arrangements of an agency.

References to Special Audit in section 38B be replaced by references to Performance Audit.

References to compliance be removed from section 38B. A new section of the Act be drafted to specify the roles, responsibilities and accountabilities of the Auditor-General in relation to compliance and regularity audit.

**FINDING**

*Parliamentary requests for the Auditor General to undertake “Special Audits” have indicated a preference for a direct audit approach - that is, detailed reports on specific topics. There is no systematic requirement, or request, for the Auditor-General to produce reports on performance statements and indicators.*

*The effect of Parliaments’ requirements has had the effect of concentrating resources in the area of direct reporting. The level of resources that goes into preparing direct audit reports is extensive.*

**RECOMMENDATION**

The Act make specific provision for the Auditor-General to certify, or attest, that performance statements and indicators prepared by management are a relevant, reliable and fair representation of the economy, efficiency and effectiveness of an agency's management, operations and service delivery arrangements.

**FINDING**

*Under present arrangements funding for performance audit work is mainly provided through:*

- *a "levy" on financial audit work*
- *parliamentary appropriation*
- *specific "fee for service" arrangements".*

*The levy on financial audit work is in effect a "cross subsidy" from financial audit to performance audit. We regard this arrangement as inconsistent with the Government's objectives of identifying the full cost of service delivery and removing, to the maximum extent possible, cross subsidy arrangements in agencies.*

**RECOMMENDATION**

The cost of performance, compliance and regularity audit be met from either:

- *Parliamentary Appropriation; and*
- *Fee for service arrangements.*

**FINDING**

*The creation of an Audit Committee of the Parliament provides a formal link between the Parliament and the Auditor-General. It would provide a mechanism for the Auditor-General to obtain specific references from the parliament and for the Auditor-General to inform the Parliament of performance and compliance audit work that is to be undertaken. . . . we are of the view that the same functions can be performed by the Public Accounts Committee. We see the role as one of consultation and discussion rather than direction and oversight.*

*We also consider that the Public Accounts Committee should take a more active role in commenting on and monitoring the outcome of performance audit work. In some instances*

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*the Committee has held follow up hearings - but this is not a regular procedure.*

#### **RECOMMENDATION**

The Public Accounts Committee adopt the following responsibilities in relation to the Auditor-General and the conduct of performance audit:

- review and discuss the annual and forward performance audit plan with the Auditor-General;
- recommend for Parliamentary approval the resources required to undertake the Audit Plan;
- review Performance Audit conclusions and recommendations following tabling in Parliament.

#### **FINDING**

*An expectation of the Public Accounts Committee in 1993 for performance audits to focus more on effectiveness issues has also created difficulties to the extent that performance audit considerations of program effectiveness run a very high risk of touching on policy issues. Section 38B of the Act precludes the Auditor-General from commenting on the merits of government policy objectives. The Audit Office sought advice from the Crown Solicitor in 1993 to clarify the restriction on commenting on policy issues, and in 1994 a further legal opinion was obtained from the NSW Solicitor-General. Solutions need to be found to the problem of varying interpretations of the Public Finance and Audit Act 1983 with respect to performance audit work and its relation to policy.*

#### **RECOMMENDATION**

In reporting on a performance audit, and without questioning the merits of policy objectives, the Auditor-General draw attention to areas where:-

- there is lack of clarity, ambiguity or inconsistency in policy goals and program objectives;
- assumed policies are not supported by documentation and evidence of the intention of Government and/or Ministers.

#### **FINDING**

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*The Audit Office has commenced a process to refine [its operational] objectives in a form that is . . . amenable to performance assessment. It has carried out client surveys, has produced a strategy document reporting on the outcome of a strategy workshop undertaken in July 1994, and has held another strategy workshop in July 1995. Unfortunately the strategy document does not contain a clear indication of the way in which the goals of the Performance Audit branch are to be achieved and how the key issues it identified are to be addressed. Although there is excess of 60 "Actions Agreed Upon" contained in the strategy document, there is no indication of time frame, order of priority or the resources that will be required.*

### **RECOMMENDATION**

The Performance Audit Branch prepare a Business Plan that clearly identifies:

- Current Mission;
- Goals and Objectives that are realistic and achievable over the short to medium term;
- Key business issues;
- The six or eight strategies to achieve goals and objectives;
- The resource implications;
- The performance indicators that will be used to report on achievement.

### **FINDING**

*The Audit Office has demonstrated that it has developed the experience to address complex topics. Its work in the area of management practices and operational and service effectiveness should continue. As the knowledge and skill base of the Office expands, however, there will be the opportunity to move the focus of audit away from the traditional approach which suggests that all information for input into the audit process should come from a single study.*

**RECOMMENDATION**

The Audit Office adopt an integrated approach to audit that combines:

- review of financial and accounting systems;
- assessment and attestation of financial reports;
- consideration of arrangements to minimise risk;
- assessment of the overall performance of individual services (on a cyclical basis);
- assessment of the effectiveness of management arrangements;
- assessment and attestation of performance statements and indicators.

**FINDING**

*This approach to audit is best undertaken in an integrated management and organisational structure. The Audit Office has a long term strategy for integrating performance audit with financial audit. The Audit Office also has a strategy that at least 50 percent of the work of the Audit Office will be directed towards performance. This will require reallocation of resources, and careful planning and implementation.*

**RECOMMENDATION**

Strategies be put in place that will achieve integration of performance audit work with the finance audit branches over a period of three to five years.

**FINDING**

*In New South Wales there is a major opportunity for the Auditor-General to take a pro-active role in the development and implementation of attest audit in relation to performance measures and reports. [However,] the quality of performance indicators and measures that are currently available would not enable the Auditor-General to systematically report, or report meaningfully on performance. There still remains significant scope for the Auditor-General to develop approaches, in cooperation with the Treasury and other central agencies, for the attest audit of key activities and processes in government agencies.*



**RECOMMENDATION**

The Auditor-General work closely with the Parliament and the Central Agencies in developing a systematic approach for performance reporting in the NSW Budget Sector.

The Auditor-General be given responsibility for undertaking attest audits of Performance Statements prepared by agency management and reporting on the accuracy, relevance and reliability of performance indicators.

**FINDING**

*With the integration of financial and performance audit into the general operational areas of the Audit Office, there would still be a need for a separate organisational unit to:*

- *develop broad based, government wide audit criteria and best practice guides that could be used to guide in performance and financial audit work*
- *develop and monitor methodology on performance audit*
- *undertake large special reviews - in the nature of special projects of a compliance nature.*

**RECOMMENDATION**

The current Performance Audit Branch continue as a separate organisational unit with an ongoing responsibility for:

- undertaking broad based, sector wide performance audits with a view to developing audit criteria, benchmarks and best practice for use in performance audit work undertaken in operational areas;
- developing the Office's methodology for audit of performance statements;
- maintenance of performance audit manuals;
- undertaking performance and related compliance and regularity audit work that does not fit easily within the client service focus and responsibilities of finance-performance audit branches.

**FINDING**

*Once an audit report is produced for the Public Accounts Committee and copies given to the agency, there appears to be little follow up.*

**RECOMMENDATION**

The Public Accounts Committee have a specific responsibility for review of Audit Office findings and conclusions and making recommendations to Government.

The Government be required to respond to Public Accounts Committee reports within a six month time frame.

## APPENDICES

1. Terms of Reference
2. Review of Performance Audits: Recommendations only  
(Professor John Glynn)
3. Glossary of Terms

<p style="text-align: center;"><b>Terms of Reference</b> for the <b>Peer Review of the NSW Audit Office</b></p>
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**1. MANAGEMENT OF THE AUDIT FUNCTION**

- To review the efficiency and effectiveness of the management of The Audit Office of NSW (The Office) in assisting the Auditor-General to discharge his statutory responsibilities under the Public Finance and Audit Act 1983.
- In the context of that review and without limiting its scope, the following management issues are important:-
  - (a) the effectiveness of the organisational and staffing structure;
  - (b) the adequacy and effectiveness of the planning process;
  - (c) the adequacy and effectiveness of systems to measure and control productivity;
  - (d) the management culture and its effect in performance;
  - (e) the relationship between the Office and its clients (including the Parliament) and any factors influencing that relationship;
  - (f) the extent to which best practice in management (including appropriate benchmarks) have been adopted in the Office.

**2. THE CONDUCT OF FINANCIAL AUDITS**

- To review the adequacy and appropriateness of the methodology, practices and procedures of The Audit Office of NSW to determine the extent by which the audit opinions issued by The Office comply with applicable professional standards and practices and in particular that they are:
  - (a) supported by adequate plans and work papers;
  - (b) supported by appropriate audit evidence involving audit tests and other procedures;

- (c) supported by appropriate quality control procedures;
  - (d) reported in accordance with the statutory responsibility of the Auditor-General.
- In the context of that review and without limiting its scope, attention should be given to:
    - (a) the effectiveness of the planning and co-ordination of the financial audit program, having regard to internal audit and technology;
    - (b) the extent to which the Auditor-General can add value to the financial audit process;
    - (c) the productivity of the financial audit process (including appropriate benchmarks).

### 3. CONDUCT OF PERFORMANCE AUDITS

- To review the efficiency and effectiveness of the management and conduct of performance audits undertaken by The Audit Office of NSW.
- In the context of that review and without limiting its scope, attention should be given to:-
  - (a) the criteria for the selection of performance audits;
  - (b) the effectiveness of the planning and control of the performance audits;
  - (c) the criteria against which the efficiency and effectiveness of the performance audits conducted by The Office are measured;
  - (d) the adequacy of the investigative process to support the conclusions arising from the performance audit and the appropriateness of quality control procedures;
  - (e) compliance with statutory requirements for the conduct and reporting of performance audits and the extent to which applicable professional standards and practices are complied with;
  - (f) the skills and competency of staff undertaking performance audits;
  - (g) the productivity of the Performance Audit Branch;

- (h) the extent to which performance audits have been agents for change in public sector management.

#### 4. MANAGEMENT OF HUMAN RESOURCES

- To review the management of human resources within The Audit Office of NSW.
- In the context of that review and without limiting its scope, the following issues are important:-
  - (a) recruitment, training and professional development of staff;
  - (b) promotion and career development;
  - (c) remuneration and work practices;
  - (d) the adequacy and balance of availability resources (including skills and competency) to enable The Office to efficiently and effectively achieve its corporate objectives and assist the Auditor-General to efficiently and effectively discharge his statutory responsibilities;
  - (e) the use of contract and/or specialist staff.

#### 5. MANAGEMENT AND USE OF TECHNOLOGY

- To review the extent by which developments in technology, including the use of computers and related tools, are being efficiently and effectively used by The Audit Office for audit related and management tasks.
- In the context of that review and without limiting its scope, particular attention should be given to:-
  - (a) the effectiveness of present policies within The Office to the utilisation of hardware and software;
  - (b) the training and development of staff in the use of technology.

**REPORT TO THE  
PUBLIC ACCOUNTS COMMITTEE  
OF THE  
NEW SOUTH WALES  
PARLIAMENT**

**'REVIEW OF THE AUDIT OFFICE OF NSW'**

**RECOMMENDATIONS ONLY**

Prepared by

Professor John J. Glynn

18 August 1995

## **RECOMMENDATIONS**

### **Recommendation 1**

I recommend that the PAC give consideration to a redraft of the performance audit legislation to remove any ambiguity as to what the performance audit mandate of the Auditor-General ought to be.

### **Recommendation 2**

The Audit Office should urgently review and agree with the PAC the basis by which performance audit topics are selected.

### **Recommendation 3**

The PAC should consider taking on the responsibility for overseeing the resources appropriated to the Audit Office so as to make more accountable the resources applied by the Auditor-General, particularly with respect to performance audits. If the PAC feels this is not their responsibility they might care to consider how this important oversight responsibility be undertaken.

### **Recommendation 4**

The PAC might wish to consider whether clients should be billed for performance audits in similar fashion to the billing for their attest/regulatory audit. This would impose a market test and discipline on the value of this audit effort.

### **Recommendation 5**

The performance audit branch should, as a matter of urgency, develop or adopt a practice guide so as to standardise the quality of performance audit reporting.

### **Recommendation 6**

The Audit Office should develop a strategic plan to best maximise the value that clients might receive from performance audits.

### **Recommendation 7**

The Audit Office should address how it might better create a cross-



**fertilisation of effort between staff in the performance audit branch and the other branches of The Office. In addition this cross-fertilisation should also embrace a closer working relationship with those private sector audit firms who do sub-contract work on behalf of the Auditor-General.**

#### **Recommendation 8**

**The PAC might consider extending the Auditor-General's mandate to undertake performance audits of local government, health and other areas which are in receipt of government funding but which are currently outside of his audit mandate.**

#### **Recommendation 9**

**The PAC should invite the Auditor-General to consider how his attest/regularity auditors might become more involved with aspects of performance auditing and should advise the Committee of any operational difficulties associated with such a move.**

#### **Recommendation 10**

**The Auditor-General should include in future client surveys questions that specifically ask for responses on the value and quality of performance audit reports.**

#### **Recommendation 11**

**I recommend that the PAC closely monitor the types of performance audits undertaken by the Audit Office and that the Auditor-General provide the PAC with brief details of the scope of each investigation, the anticipated outcomes and estimated (total) cost.**

#### **Recommendation 12**

**I recommend that only the PAC should approve the performance audits undertaken by the Auditor-General. If the Executive feels that it wishes the Audit Office to undertake such investigations then such requests should properly be channelled through the PAC for consideration.**

#### **Recommendation 13**

**The Auditor-General should instigate a series of initiatives to remove the perceived barriers between the various branches of The Office so as to instill in all staff a sense of corporate identity, shared vision and**

goals.

**Recommendation 14**

**the Auditor-General should prepare a plan for the PAC outlining required competencies for all grades of staff involved in performance auditing and the associated training and development programme to ensure that such competencies are achieved and maintained.**

**GLOSSARY OF TERMS**

Accrual accounting:	Accrual accounting is the recognition of revenue and expenditure items as they are earned or incurred respectively (and not as money is received or paid) and included in the financial statements in the year to which they relate. Accrual accounting provides a clear and immediate picture of an agencies current position relating to its assets and liabilities.
Appropriation Act:	The Act passed by Parliament each year authorising the payments out of the Consolidated Fund for recurrent and capital payments.
Assets:	A general term covering financial resources (cash, securities, etc), physical items (property, plant and equipment etc) or intangibles (patents, trademarks, etc) capable of providing a future benefit to the organisation either by use or sale.
Auditor-General:	A statutory office established under the Public Finance and Audit Act 1983 to audit and report to Parliament on the Public Accounts and the accounts of departments and authorities.
Attestation:	The act of witnessing e.g. that a document has been signed. The auditor's attestation expresses their opinion of the truth and fairness of the financial statements.
Audit:	The systematic examination of

accounts for the purpose of determining their validity and accuracy.

This may be an *internal audit* conducted by a person engaged within an agency or an *external audit* which is a periodic independent examination or verification of the assets, liabilities and financial transactions of an entity by a professional accountant engaged for the purpose.

Audit Office:

The office established to fulfil the role and functions of auditing the public sector, headed by the Auditor-General.

Audit opinion:

A positive written expression within the specified framework of accepted accounting standards indicating the auditor's overall conclusion based upon audit evidence obtained that provides a high level of assurance:

- (a) to enhance the credibility of an assertion about an accountability matter; or
- (b) about the subject matter for which the accountable party is responsible.

Auditing practices/standards:

The procedures by which auditors are required to comply with in the process of auditing.

Audit sampling:

The application of audit procedures to less than 100% of the items within a sample to obtain audit evidence used to form a conclusion about a particular characteristic of the population.

Auditor:

The person with final responsibility for the audit or audit related service engagement.

Big 6:	The top six accounting firms in Australia that includes Price Waterhouse, Coopers & Lybrand, KPMG, Deloitte, Arthur Andersen and Ernst & Young.
Bench marking:	A management technique whereby the performance of a particular organisation is compared with measured performance data of like organisations or other established reference point.
Benchmark Matrix:	The set of criteria for the Bench marking process.
Best practice:	A standard which is set at the highest level following the analysis of performance outcomes by other performers in that area.
Budget sector:	<p>The formal definition of the budget sector as used by Treasury includes inner and outer budget sector bodies:</p> <ul style="list-style-type: none"> <li>- inner budget sector bodies include all departments and certain statutory authorities, which are funded from the Consolidated Fund. They are subject to Ministerial direction and comply with the PFA Act 1983, Annual Reports (Departments) Act 1985 and audit by the Auditor-General.</li> <li>- outer budget sector bodies include certain statutory bodies (eg. State Rail Authority), are funded mainly from own charges, are subject to Ministerial direction and comply with the PFA Act 1983, Annual Reports (Statutory Bodies) Act 1984 and audit by the Auditor-General.</li> </ul>

CAAT:	Computer Assisted Audit Techniques: any technique that uses a computer as an audit tool.
CIS Audit:	Computer Information Systems audit
Compliance auditing:	An audit examination to determine the extent to which an organisation has adhered to legislative and other regulatory requirements.
Conduct of financial audit:	An audit of financial information aimed to provide sufficient evidence for the Auditor to express an opinion on a set of financial statements.
Consolidated Fund:	An account for revenue received by government including payments by departments and certain authorities within the budget sector. Payments out of this fund finance particular government activities as approved by the Parliament.
Corporate governance:	Unofficial guidelines set by the corporate nature of businesses which sets parameters in their drive to be efficient and competitive.
Corporatisation:	The restructuring of a public trading enterprise to enable it to operate at arm's length from government. Profit becomes a major object

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Crown Solicitor's Office:	The Office providing legal services to the NSW Government, departments/agencies and statutory authorities.
Customer councils:	A group of users of services provided by an organisation that form a body to discuss the quality of services of that organisation.
Independence of Auditor-General:	As established in the Westminster system, the Auditor-General is required to be independent of the Executive Government. This is due to his role in auditing public sector accounts which may potentially highlight inefficiencies in the public sector and therefore embarrass both public servants and Ministers of the Crown. In order to perform the Auditor-General duties free of influence, absolute independence from the Executive is paramount.
IS Audit:	Information Systems audit.

Engagement Controller:	A person employed by the Audit Office to control a particular audit engagement and in many cases has delegation from the Auditor-General to sign the financial audit opinion.
Engagement letter:	The letter which documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the entity and the form of any report.
Engagement Reviewer:	A person employed by the Audit Office to review the work conducted by a Engagement Controller as a quality control measure prior to the Audit opinion being signed.
Global budgets:	An overall budget which is not restricted by line items thus giving management a degree of flexibility in how it spends the budget allocation.
Financial attest audit:	An audit to form an opinion on sets of financial statements and compliance with financial management requirements.
Government Trading Enterprises (GTE):	Public sector agencies/units which operate on commercial guidelines.
Irregularities:	This can refer to fraud, other illegal acts, non-compliance, intentional omissions or errors.
Mandate:	The authority given to undertake a particular area of audit.
Non-budget sector:	This sector, which is outside budget sector constraints, includes universities, marketing authorities etc. Some are not subject to



ministerial direction, recurrent services and capital works not funded from The Consolidated Fund but are subject to PFA Act 1983, Annual Reports (Statutory Bodies) Act 1984 and audit by the Auditor-General.

Parliamentary audit committee:	A committee of parliamentarians which is responsible for the oversight of the Auditor-General's Office on behalf of the Parliament.
Peer review:	As referred to in this report, a panel of auditing peers who investigate the operations of the Audit Office.
Performance audit (special audits):	An auditing practice that examines the efficiency, economy and effectiveness of the accounts of an organisation in achieving its policy objectives.
Performance indicators:	A set of criteria against which the performance of an organisation is measured.
Public Finance and Audit Act 1983:	The Act which legislates financial requirements which NSW public sector agencies are required to adhere to.
Public Accounts Committee (PAC):	A Lower House parliamentary committee comprising of backbencher politicians that investigates matters arising from the Auditor-General's reports as well as any matters involving the economy, efficiency and effectiveness of NSW government departments/agencies.
Quangos:	Quasi autonomous non-government organisations.
Review engagement:	A service where the auditor's

objective is to provide a moderate level of assurance, being a lower level of assurance than that provided by an audit, through:

- (a) the issue of a statement of negative assurance that enhances the credibility of a written view on an accountability matter (attest review); or
- (b) the provision of relevant and reliable information and a statement of negative assurance about an accountability matter where the party responsible does not provide a written view (direct reporting review).

Scope of an audit:	A term referring to the audit procedures deemed necessary in the circumstances to achieve the objective of an audit.
Senior Executive Service (SES):	A selective band of highly ranked executives who form the core of senior management positions in the NSW public sector, engaged under contract.
SWOT analysis:	Strengths, Weaknesses, Opportunities and Tactics: management tool of analysis.
Total Quality Management:	A management technique that addresses quality of the work processes across the whole organisation.
Treasurer's Directions:	Directions issued by the Treasurer, under section 9 of the Public Finance and Audit Act 1983, covering accounting practices and procedures of departments and those statutory bodies not specifically exempted from the

Directions.

User charges:

A charge paid by the receiver or user of a good or service.

Value for money:

see performance audit