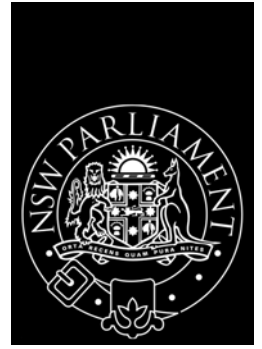


LEGISLATIVE ASSEMBLY



Public Accounts Committee

REVIEW OF THE AUDIT OFFICE UNDER SECTION 48A,
PUBLIC FINANCE AND AUDIT ACT 1983

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Final Report

New South Wales Public Accounts Committee
Review of the New South Wales
Audit Office under Section 48A,
Public Finance and Audit Act 1983

June 2009



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1 Introduction and Mandate for the Review

1.1 Introduction

The Public Finance and Audit Act 1983 (the Act), details the legal basis for the accounting and audit arrangements for the New South Wales Public Sector. The Public Sector for the purposes of the Act includes the central revenue and spending powers of the State, various Government Departments, Statutory Authorities and related bodies and State Owned Corporations.

Under section 48A of the Act, the Public Accounts Committee (PAC) is obliged to appoint a reviewer to conduct a review of the Auditor-General and his or her Office at least every three years. Section 48A(2) states 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 of the Auditor-Generals functions under this Act.*

The last independent review was undertaken in 2006 with the report tabled before Parliament in August 2006. In accordance with the Act the PAC was required to ensure the conduct a review of the Audit Office during 2009. Following a competitive tender process Oakton Services Pty Ltd was appointed to undertake the review and this Report forms the results of our work.

1.2 The Role of the Auditor-General

The Auditor-General is the external auditor for the NSW public sector. The Auditor-General is appointed to office by the Governor for a non-renewable term of seven years. The current Auditor-General, Mr Peter Achterstraat, was appointed in 2006.

Section 27 B (3) – (5) of the Act defines the role and functions of the Auditor-General, which include the following:

- to audit the consolidated financial statements, the general government sector financial statements and any other financial reports that the Auditor-General is required or authorised to audit by law;
- to provide any particular audit or audit-related service to Parliament at the joint request of both Houses of Parliament;
- to provide any particular audit or audit-related service to the Treasurer at the request of the Treasurer or to any other Minister at the request of that other Minister;
- to report to Parliament as required or authorised by law; and
- to do anything that is incidental to the exercise of the Auditor-General's functions.

The Auditor-General may exercise his or her functions in such manner as the Auditor-General thinks fit. However, the Auditor-General is required:

- to have regard to recognised professional standards and practices; and
- to comply with any relevant requirements imposed by law.

The Auditor-General may, in the exercise of his or her functions, have regard to whether there has been:

- any wastage of public resources, or
- any lack of probity or financial prudence in the management or application of public resources.

1.3 The role of the Audit Office of New South Wales

The Audit Office of New South Wales is a statutory authority, established under the Act, that conducts audits for the NSW Auditor-General. The financial and performance audits are conducted principally under the Act and the

Corporations Act 2001, together with the examination of allegations of serious and substantial waste of public money under the Protected Disclosures Act 1994.

The Audit Office of NSW has approximately 260 employees whose role is to provide the Auditor-General with the staff and resources to undertake his responsibilities. Amendments to the Act in 2005 have removed the Audit Office from Chapter 2 of the *Public Sector Employment and Management Act 2002*, enabling the Auditor-General to determine the conditions and benefits of employment of members of the staff of the Audit Office aimed at improving flexibility in meeting audit work cycle needs and the Office's ability to attract and retain high quality staff.

In some cases whole or part of audit engagements are contracted out to audit firms in the private sector. Private sector audit contractors are usually engaged on the basis of specialist skills required for specific audits or for audit engagements located in areas where it is more economical to contract out the whole audit process. Over the past few years approximately 10% of audits by number and value have been contracted out. The Audit office maintains oversight of these arrangements and delegated staff are responsible for the signing of statutory audit opinions and reports.

1.4 The Public Accounts Committee (PAC)

The Public Accounts Committee (PAC) is established under the Act as a statutory committee of the New South Wales Parliament comprising six members of the Legislative Assembly appointed for the duration of the four year Parliament. Under the Act, the Committee has a broad charter to review and report on the financial management and accountability matters across the NSW public sector on behalf of the Legislative Assembly.

The role of the PAC includes a limited oversight role of the Auditor-General by virtue of:

- its power under section 57A of the Act of veto over the appointment of candidates to the position; and
- its power under section 48A of the Act to appoint a reviewer to conduct an independent review of the Auditor-General.

The PAC is also empowered under the Act to examine any report of the Auditor-General and has recently adopted the practice of reviewing the response of the relevant government agency to all performance audits 12 months after their tabling. The Committee meets regularly with the Auditor-General and seeks to improve knowledge of the Auditor-General's work within the Parliament by hosting briefing sessions for members on the Auditor-General's reports.

The PAC is responsible for determining the terms and conditions for the reviewer's appointment as well as being able to give the reviewer binding directions. In addition to providing assurance regarding the auditing practices and standards of the Auditor-General, these reviews present opportunities to improve the Audit Office's operations and resolve issues between the Audit Office and its stakeholders.

2 Executive Summary

2.1 Report Format

Section 4 of this Report outlines the Scope of the Review and individual Terms of Reference as issued by the PAC. Our approach and methodology to addressing each of the scope items has been outlined in Section 5.

The review team has addressed each of the Terms of Reference and our findings and associated recommendations are detailed in Section 6. Where appropriate we have split the findings into the three core areas of work performed by the Audit Office, being Financial, Performance and Compliance Audit. Within Section 6 for each Terms of Reference One to Five we have provided:

- Conclusion – provides an overall response based on all work undertaken in relation to the Terms of Reference.
- Findings – provide an overview of the results of key areas of the review based on the work undertaken as outlined in our approach and methodology. The report does not attempt to detail all of our findings. Rather we have focused on the key areas of relevance for the PAC and the Audit Office.
- Issues and Recommendations – we have interspersed our findings with issues and recommendations where appropriate. Where an opportunity for improved processes or area of non-compliance has arisen we have highlighted this issue and provided a specific recommendation where appropriate. Where no recommendations have been made in relation to a specific terms of reference we have stated this fact.

For Terms of Reference Six – Previous Review, we have provided the summary of the issue to which the recommendation related an update of the current situation and actions taken and an assessment of whether we believe it has been appropriately addressed.

Section 3 includes the Auditor-General of NSW Response to the Report together with a summary of the recommendations and the Audit Office Response.

2.2 Overall Conclusion

We have been able to provide positive conclusions in relation to all of the Terms of Reference subject to this review. Evidence gathered from our fieldwork demonstrated that the Auditor General and the Audit Office has in place robust and professional frameworks to effectively and efficiently deal with its core business and to interact with its clients.

2.3 Key Findings

2.3.1 Auditing Function

Financial Audit

The Audit Office has in place a robust audit methodology which is supported through effective enabling tools and a quality review framework to assist in ensuring compliance with professional standards and legal requirements. Our detailed review work on a sample of client files did not find any significant issues in relation to departures during the application of the methodology.

Discussions with clients, our own survey results and those of the Audit Office client survey reflect a high level of satisfaction with the Financial Audit process. Elements of dissatisfaction are primarily sourced

from a minority of smaller agencies and often reflect resource management issues and the legislative impost of the Act, both of which are beyond the direct control of the Audit Office.

There remains an ongoing need to continue to focus on ensuring consistency in the application of the methodology across the various financial audit business teams as this will promote continuous improvement and efficiency. The Audit Office has in place the mechanisms to seek continuous improvement in the delivery of its services, within its resource and legislative constraints.

We note the potential need to replace the current Financial Audit method and enabling software when the current licence ends in December 2010. This will need to be carefully managed and we would encourage the Audit Office to consider the method and software used in other comparable jurisdictions.

Performance Audit

The Audit Office has implemented a robust framework to ensure compliance with all professional and legal requirements in relation to the conduct of performance audit and we were, in general, satisfied with the application of this framework to sample of performance audits we reviewed.

The INTOSAI Performance Audit methodology was introduced in 2005 and as a consequence has been through a “bedding down” process over the period of the review. Consequently a range of minor issues were identified that relate to the process of managing changes in audits once they have already commenced and issues for managing the review and reporting processes.

The recent adoption of the performance audit report follow up process by the PAC is a positive move which should enhance accountability. In addition the Auditor General has recently adopted a process of early termination of reviews if, after the initial detailed planning processes, the lines of inquiry are not yielding a significant return against the audit objective. Both of these initiatives should enhance the overall effectiveness of the performance audit program by enabling resources which have been freed up to be used on other performance audits.

Compliance Audit

Due to the diversion of Financial Audit Branch resources to dealing with the increased requirements of new Auditing Standards as they were applied to Financial Audits, no compliance audits were performance during 2007 and 2008.

During the course of our review the Audit Office developed a new compliance audit framework for application in a limited program for 2009. Our review of this framework indicates it is in accordance with professional standards.

2.3.2 Costs and Charges

Based on the results of our work we are satisfied that the Audit Office is providing value for money for both Financial and Performance Audit services.

In relation to Financial Audit, fee increases have been maintained at the lower end of the industry benchmarks, taking into consideration the impact of new Auditing Standards which increased the amount of financial audit work required.

Based on our own survey of agencies, there remains a minority of smaller entities who do not believe the Audit Office provides value for money. The nature of legislative requirements and changes in Auditing Standards in general places a relative burden on smaller agencies that is not commensurate with their size. However this issue is predominantly outside of the Audit Office’s direct control.

The changes over the last few years, first with regard to Accounting Standards and more recently Auditing Standards, have put increased pressure on Audit Office resources. However the relative size of the Financial Audit Branch and Audit Support, when compared to other jurisdictions who outsource more of their work, has assisted in ensuring a relatively trouble free transition, through being able to effectively

and efficiently adopt the new requirement. The current Clarity Project being undertaken by the Auditing and Assurance Standards Board (AUASB) is likely to put further pressure on Audit Office resources and fees when the revised Auditing Standard are introduced from 2010.

The Performance Audit program also appears to be providing value for money by delivering against objectives and enhanced accountability through improved administrative practices, increasing transparency of process and supporting the role of the PAC. Ultimately an assessment of value for money rests with Parliament and can be gauged by the recommendations agreed and actioned by agencies, improvement in process controls and accountability more broadly and the level of appropriations received.

2.3.3 Planning

Our review procedures revealed that the process for selecting performance and compliance audits is based on a robust methodology and this has been strengthened through the adoption of the Whole of Office Strategic Audit Planning (SAP) process which combines the input of the Financial and Performance Audit branches through defined Audit Office Special Interest Groups (SIG), which monitor risks and issues across government sectors.

The transparency of the process for the SAP and making changes to the plan could be improved as it is currently limited to the annual announcement of the Performance Audit plan. The publication of a more detailed three year SAP would assist in stakeholder communication and would be enhanced with formal notification of changes to the plan as new issues and areas for immediate review arise.

The nature of the Compliance audit program means that topics are selected on a “whole of government risk” rather than agency risk profiles. However, with the introduction of the new compliance audit framework, an opportunity exists to provide further guidance on the selection of specific agencies for inclusion in a particular compliance audit program.

2.3.4 Management and Resources

We are satisfied that the NSW Audit Office has adequate management and resources to perform its core Financial Audit functions in terms of legislative and professional requirements.

Resources in relation to Performance Audit are largely determined by the level of funding which scopes the size of the current Performance Audit plan to be delivered through the use of the current Performance Audit methodology. In addition our work supported the view that appropriately skilled staff are undertaking performance audits, with the supplementary use of expert consultants where necessary.

In relation to the introduction of the revised Compliance audit program for 2009 we support the approach of seeking separate funding as this will enable this program to be reactivated independently of the Financial Audit process as it avoids the cross subsidisation with Financial Audit that use to occur.

2.3.5 Communication with Clients

Enhancing communication with clients has been a focus of the Audit Office in recent years and our work in relation to the specific Terms of Reference areas of fees and variations, scope of Performance Audit programs and notice on draft reports has yielded positive review results.

However, the results of our own client survey, as well as the surveys undertaken by the Audit Office, reveal that communication remains an area for ongoing focus.

A key recommendation is in relation to the publishing of a rolling three year plan of Performance and Compliance Audits. This could consider both past and potential future proposed audits and provide an incentive for improved accountability prior to audits commencing. It would obviously remain subject to changing circumstances. We note a similar plan is published by the Victorian Auditor General.

2.3.6 Recommendations from Previous Review

Our review results noted that significant progress had been made in addressing the recommendations made in the previous 2006 PAC review.

We determined that the majority of recommendations have been fully addressed by the Audit Office. Three recommendations have been partially addressed and one was no longer applicable.


2.4 Acknowledgements

Oakton would like to thank the Auditor-General and all the Audit Office personnel who participated in the review, the members and Secretariat of the PAC who provided timely assistance to us, and senior staff of Public Sector Agencies and other State Audit Offices who responded to our survey and requests for meetings.

In particular, the co-operative and positive attitude towards the review from all the Audit Office staff was very encouraging.

3 Summary of Recommendations and Auditor-General of NSW Response to the Report

Below is the formal response of the Auditor-General of NSW to the Report. This includes an attached table providing a summary of the key issues and recommendations arising from the review, together with the Audit Office response. Further detail on the findings is provided in Section 6.



THE AUDIT OFFICE
OF NEW SOUTH WALES

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Mr Paul McLeay
Chairman
Public Accounts Committee
Parliament House
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SYDNEY NSW 2000

6 July 2009

Dear Mr McLeay

Triennial Review of the Audit Office of New South Wales


This letter is my response to the 2009 review of the Audit Office, carried out under section 48A of the *Public Finance and Audit Act 1983*.

The Audit Office and I welcome these independent reviews of our activities. We are committed to a culture of continuous improvement and these reviews can help us achieve that aim. We also believe that we should be no less accountable than the agencies we audit.

The review's findings are a very positive endorsement of the robust and professional frameworks we have in place to effectively and efficiently deal with our core business and to interact with our clients.

We accept all the recommendations made by the reviewers and will implement them as soon as possible. Together with the other observations and findings in the report, they will assist the Office in achieving our vision of making the people of New South Wales proud of the work we do.

Yours sincerely


Peter Achterstraat
Auditor-General

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Ref (Page)	Terms of Reference	Issue	Recommendation	Audit Office Response
#1 Page 19	One (A) Financial Audit	The current licence agreement for the Audit Offices AS2 financial audit software supplied by Deloitte is due to expire in December 2010. The lead time on ensuring an appropriate replacement audit enabling software is found and can be successfully implemented with the follow on changes to methodology is likely to be in excess of 12 months.	The Audit Office implement a project to review the market for appropriate financial audit methodology and enabling software. Consideration should be given to the software used by other comparable jurisdictions.	Agreed. We intend to implement a project to review the market for appropriate financial audit methodology and enabling software. We will consider the software used by other comparable jurisdictions.
#2 Page 20	One (A) Financial Audit	Many of the Financial Audit files we reviewed contained checklists with provision for internal sign off by the reviewer and the date of review. These were not always completed, although the forms had been signed off at the index level in the AS2 software indicating that the work had been completed. Signing off the actual checklists provided the best evidence of the actual work undertaken.	Reinforce the need to comply with the Audit Office requirements to sign off checks and approvals within current Financial Audit processes. Consider reintroduction of Mini Quality and Review Committee (QARC) or revised file completion checklist utilising the existing "status of Forms and Templates" document to assist in ensuring compliance.	We agree that signing the actual checklist provides the best evidence of the actual work undertaken. Staff will be reminded that checklists with provision for internal sign off by the reviewer need to be signed off internally, not just at the index level.
#3 Page 21	One (A) Financial Audit	There is an opportunity to improve the transparency of workpapers by adopting a more consistent approach to raising potential audit issues and following these through to their resolution. Standardisation will improve audit and audit review efficiency and reduce the likelihood of issues being overlooked.	Promote the use of a standardised approach to raising and resolving potential audit issues throughout workpapers.	Agreed. We will consider the options available and implement a standardised and consistent method to: <ul style="list-style-type: none"> record audit issues follow them through to resolution thereby improving audit efficiency and reducing the risk of issues being overlooked.

Ref (Page)	Terms of Reference	Issue	Recommendation	Audit Office Response
#4 Page 21	One (A) Financial Audit	Some workpapers appeared incomplete because comments and review points had not been documented as having been addressed and resolved.	Reinforce process for clearing review points in accordance with revised approach adopted by the Audit Office	Agreed. Review notes are no longer retained on final audit files. All matters raised in review notes must now be adequately addressed in the relevant workpapers.
#5 Page 21	One (A) Financial Audit	<p>The QARC cold review process is a key method of ensuring consistency and continuous improvement. The level of the program in 2007 and 2008 was in accordance with APES 320 Quality Control for Firms and aimed to cover all Business Team Leaders (BTL) on a rolling 3 yr basis. However the timing of the reviews meant that the results were not available to build into the subsequent years planning processes</p> <p>Management have increased the number of reviews to cover all BTL's across the annual cycle during 2009 with results expected to be communicated prior to 30 June.</p>	<p>We support current initiative to ensure annual program of QARC reviews covers all Business Teams.</p> <p>We recommend the timing of the review be changed to enable lessons learnt to feed back into the subsequent years planning cycle.</p>	The timing of reviews and reporting is being accelerated to ensure findings are released prior to the subsequent planning cycle.
#6 Page 22	One (A) Financial Audit	There has been a poor response rate on the client and Audit Office reviewer in house surveys for Contract Audit agents – approximately 30% over the last three years. Client and Audit Office reviewer response is an important element in overall quality control process	The Audit Office promote completion of Client and Reviewer Surveys for all contracted audits	Agreed. We will promote completion of Client and Reviewer Surveys for all contracted audits.

Ref (Page)	Terms of Reference	Issue	Recommendation	Audit Office Response
#7 Page 24	One (A) Performance Audit	The AG's Practice Manual currently refers to a 'Performance Audit Policy' that does not exist.	The AGs Practice Manual needs to be updated to include a 'Performance Audit Policy' that it currently refers to but which does not exist. The Policy should bring together the Audit Offices mandate for performance audit together with the methodology framework for use in all Performance Audits and the alignment with professional standards.	The Practice Manual is being updated and will reference to the existing document "Performance Audit Branch Quality Control System – Policy and Procedures".
#8 Page 26	One (A) Performance Audit	Without a formal assessment of the "lines of inquiry" against the Risk Matrix of potential options for lines of inquiry the basis for the approach taken to a particular performance audit is weakened.	Formal assessment of the lines of inquiry against the defined Risk Matrix should be conducted in all instances as part of the planning stage of each performance audit.	This is part of current requirement. Teams to reminded of this and compliance to be monitored.
#9 Page 26	One (A) Performance Audit	Audit documentation did not demonstrate a link between the individual planning being undertaken on a specific audit and the overarching Strategic Audit Plan.	Individual audit plans should have tangible links to the Strategic Audit Plan and these should be incorporated into the planning documentation at the commencement of the audit.	This is part of current requirement. Teams to be advised to address this in the audit plan and compliance to be monitored.
#10 Page 27	One (A) Performance Audit	Process and requirements around the current "HOT" review process is limited. This may impact the quality of the final product.	The roles of the Hot Reviewer to be further defined and to include: <ul style="list-style-type: none"> • a mandated responsibility to sign off that the audit approach complies with the internal methodology. • ensuring that the question posed by the audit aligns with the conclusions reached and that this is consistent with the planned objective • ensuring that lines of inquiry have been 	The Engagement ("Hot") Reviewer sign-offs will be clarified to address these points. The "Performance Audit Branch Quality Control System – Policy and Procedures" will be amended regarding the reviewer's knowledge of the methodology and awareness of compliance issues.

Ref (Page)	Terms of Reference	Issue	Recommendation	Audit Office Response
			<p>properly pursued and that the reason behind any divergences from these is transparent in working papers.</p> <p>Staff undertaking the "HOT" reviewer role need to be well trained in the use of the Audit Office's internal methodology and be aware of likely issues of compliance.</p>	
#11 Page 27	One(A) Performance Audit	The weekly status report is an important means of advising the audit manager of issues as they arise throughout the audit. It is an important compensatory control (for management) that ensures all planning criteria have been addressed in those instances where the audit trail from the audit plan to the fieldwork conducted is not particularly clear. The audit noted some gaps in the provision of weekly status reports.	The importance of the weekly status report be enforced through mandated adherence to policy.	Agreed.
#12 Page 28	One (A) Performance Audit	There was no tangible evidence of how the Risk Management Strategy, which is completed as part of the audit planning process, is revisited during the audit along with analysis of whether risks where realised fed into audit process improvement. The Strategy covers both audit process and risks related to the audits objectives. It is likely that during the course of the audit risks may be realised and new strategies or changes in methodology adopted to mitigate the risks.	The Audit scorecard, which provides an internal assessment at completion of the audit, should be expanded to incorporate an assessment against the Risk Management Strategy, to ensure contingent issues identified in the planning stage are satisfied throughout the course of the audit and provide appropriate closure.	Agreed.
#13	One (A) Performance	In one audit, the lines of inquiry provided in the final report varied slightly from the lines of	It is recommended that the clearance process for reports include provision that there has	This is part of current requirement. Teams to be advised to address this and

Ref (Page)	Terms of Reference	Issue	Recommendation	Audit Office Response
Page 28	Audit	inquiry in the planning documentation. The variation suggested to the reader that the audit may have represented a change in scope.	been reconciliation between planned audit objectives, criteria, scope, lines of inquiry and the audit objectives, criteria, scope and lines of inquiry published in the final report.	compliance to be monitored..
#14 Page 28	One (A) Performance Audit	In one audit, the audit opinion was not a specific statement against the audit objective and while there was an implied opinion, there was no definitive statement to satisfy the reader that the audit objective had actually been achieved.	Opinions in the published report must address the primary objective of the audit. Contextual discussion supporting the opinion must specifically address each line of enquiry to ensure the report is structured in a manner that is consistent with the audit plan	This is part of current requirement. Teams to be advised to address this and compliance to be monitored.
#15 Page 34	Two (B) Performance Audit	The new role of the PAC as the body responsible for following up the implementation of audit recommendations is a significant improvement in the Audit Office's ability to promote greater accountability. To enhance this process, the findings of the PAC follow up should be formally fed back into the Audit Offices Strategic Audit Planning process.	Follow up reviews conducted by the PAC should be formally fed back to the AG to inform the SAP process.	Agreed.
#16 Page 36	Three (A) Performance Audit	<p>It was noted that some audits commenced during the year did not stem from the planning process conducted but were initiated from other sources.</p> <p>Existing processes do not document consideration of the merits of commencing these audits against others marked for completion.</p> <p>Commencing audits which have not arisen from the agreed planning processes renders much of</p>	<p>The Strategic Audit Planning process should be broadened to reflect discretionary 'unplanned' audits which arise during the current period. These changes should be published in a revised SAP on the agency website.</p> <p>The Audit Office commit to a rolling three year strategic audit plan which is updated regularly to make explicit the implications of commencing previously unplanned audits and to reflect segment and industry coverage over</p>	<p>Agreed</p> <p>Agreed</p>

Ref (Page)	Terms of Reference	Issue	Recommendation	Audit Office Response
		this planning redundant and may result in an inefficient use of resources.	the period.	
#17 Page 37	Three (B) Compliance Audit	The selection of agencies for inclusion in the initial 2009 Compliance audit program has been based on a list of affected agencies and then smoothing coverage across business teams. This may result in a sample selection that does not reflect a cross section of Governments risk profile in relation to the particular compliance risk subject to audit	Selection of agencies for inclusion within compliance audits should primarily be based on ensuring an appropriate representation across the Governments risk profile in relation to the compliance risk subject to audit. We suggest the new Compliance Audit Framework is amended to provide guidance on agency selection.	We believe the selection of agencies for inclusion in the 2009 compliance program reflects the government's risk profile as it is based on The Treasury's 'nominated' agency listing. These agencies have the more strategic asset holdings that support government services. Wherever possible a nominated agency was selected for each business team. The selected agencies were discussed with The Treasury to confirm their appropriateness for inclusion in the review program.
#18 Page 39	Four (A) Compliance Audit	During 2007 and 2008 the Audit Office did not conduct a separate Compliance Audit program. The primary reason for this was the divergence of resources to deal with changes in Accounting and then auditing standards. This has resulted in an increase in overall time spent on Financial Audits. As part of the reintroduction of Compliance audit program the Audit Office is in the process of seeking separate funding from Treasury.	We support the Audit Offices initiative of seeking separate funding for its compliance audit program. The office should seek that the program becomes fully funded to avoid potential issues with cross subsidisation with Financial Audit.	We confirm the Audit Office is in the process of seeking separate funding from Treasury for the compliance program.
#19	Four (B) Performance	There was no tangible evidence sighted of how the audit Development Plan, which is part of the Performance Audit planning process and	The Audit Scorecard which provides an internal assessment at the completion of the audit, should be expanded to incorporate an	Agreed.

Ref (Page)	Terms of Reference	Issue	Recommendation	Audit Office Response
Page 41	Audit	<p>highlights areas for on the job development, feeds back into staff development.</p> <p>In addition we noted there appeared to have been only limited access to the available client surveys for use in consideration of staff performance and development.</p>	<p>assessment against the Development Plans to ensure issues identified in the planning stage are satisfied throughout the course of the audit and provided appropriate feedback to audit staff where necessary.</p> <p>The practice of disseminating the performance audit client surveys should also be enhanced to ensure timely feedback is provided where possible to feed into staff development..</p>	
#20 Page 44	Five (B) Planning	<p>There is currently only limited disclosure with regards to the scope of the performance and compliance audit programs. Publishing a plan ensuring effective notice is provided across all stakeholder groups and may have the added benefit of improving accountability without the need to undertake all audits</p>	<p>The Audit Office should consider publishing a rolling three year plan of performance and compliance audits similar to that published by the Victorian Auditor General's Office. This can consider both past and potential future proposed audits and provide an incentive for improved accountability. It would remain subject to changing circumstances.</p>	<p>We will publish details of the proposed numbers of performance audits across outcome areas over the medium-term.</p>
#21 Page 46	Six	<p>Our analysis of the status of previous recommendations revealed that whilst most have been fully addressed, some items in relation to three areas have only been partially addressed. In addition the Internal Audit pre PAC Triennium Review undertaken prior to our assessment raised a number of recommendations which the Audit Office have agreed to action.</p>	<p>In order to formally close out the 2006 Recommendations the Audit Office should assess whether any further action is required in relation to partially addressed recommendations and ensure all recommendations raised in the recent Internal Audit are actioned as appropriate.</p>	<p>We will assess what further action is required in relation to the partially addressed recommendations from the 2006 review.</p> <p>We will ensure that the recent Internal Audit recommendations are appropriately actioned.</p>

4 Scope and Terms of Reference

4.1 Scope of the Review

The scope of the review as outlined in Section 48A(2) of the Act, and defined in the terms of reference issued by the PAC was:

“to assess and provide advice and recommendations about the auditing practices and standards of the Auditor-General and to determine whether the Auditor-General is complying with those practices and standards.

The purpose of the review is to determine whether the Auditor-General is performing his functions in accordance with the Public Finance and Audit Act 1983 and professional and legal requirements. The review should also consider whether these functions are performed effectively and efficiently, in a way that and enhances the performance of the New South Wales public sector.”

4.2 Terms of Reference

Particular issues noted for consideration in the terms of reference issued by the PAC were as follows:

TERMS OF REFERENCE ONE – AUDITING FUNCTION

- a) Compliance with current professional standards and legal requirements in undertaking auditing of all types.

TERMS OF REFERENCE TWO – COSTS AND CHARGES

- a) Whether the Audit Office was providing value for money financial audit services in comparison with the services and fees of similar organisations; and
- b) Whether Performance Audits provide value for money by meeting their objectives and contributing to improved accountability by agencies within New South Wales.

TERMS OF REFERENCE THREE - PLANNING

- a) Whether the process of selecting topics for performance and compliance audits was based on robust methodology including a consideration of whole of government risk management and central agency priorities; and
- b) Whether the selection of agencies for inclusion in compliance audits was robust and based on a consideration of the particular risks of that agency.

TERMS OF REFERENCE FOUR – MANAGEMENT AND RESOURCES

- a) Whether the Audit Office has adequate resources to conduct its functions; and
- b) Whether appropriately skilled staff are undertaking performance audits.

TERMS OF REFERENCE FIVE – COMMUNICATION WITH CLIENTS

Effective communication with clients in particular in relation to:

- a) Establishing a joint understanding of expected audit fees and potential variations;
- b) The scope of the performance and compliance programmes and of individual audits within these programmes; and
- c) Provision of adequate notice of draft reports to Parliament for larger agencies to provide informed comment.

TERMS OF REFERENCE SIX – PREVIOUS REVIEW

Assessment of the Audit Office’s response to the recommendations of the 2006 Review of the Audit Office.

TERMS OF REFERENCE SEVEN - GENERAL

Any matter that may be referred to the reviewer by the Committee during the course of the review.¹

¹ No matters were referred to the Review team by the PAC during the course of the Review.

5 Methodology and Approach

5.1 Overview

Our general approach to this review included a mixture of internal and external analysis in relation to the operations of the Audit Office as follows:

Internal analysis:

- Establish what, if any, monitoring and review of functions/processes is undertaken by the Audit Office as part of its own internal governance. Obtain and review financial and operational management information produced in relation to audit engagements, audit administration and management, and any relevant management, consulting or internal audit reports commissioned by the Audit Office;
- Obtain and review any internal policy and guidance material produced for currency and comprehensiveness;
- Carry out initial interviews with key Audit Office personnel;
- Select and review a sample of relevant audit engagements. Our samples included thirteen financial audits and six performance audits; and
- Review of Audit Office Audit Committee governance structure including reviews conducted and their results.

External analysis:

- Review and analyse research on public and private sector audit;
- Review and analyse International, National and State Government standards and proposals on public and private sector audit;
- Obtain relevant comparative data on financial, compliance and performance auditing and on administration and management from other Australian State government jurisdictions and from equivalent overseas jurisdictions from both the public and private sectors. This included visits to the Victorian Auditor General's Office and the Australian National Audit Office;
- From our detailed fieldwork select a sample of audit clients and interview key personnel across financial and performance audit assignments;
- Undertake a survey of Financial and Performance audit clients in relation to garnering their responses to questions in relation to specific areas of our terms of reference. We received 100 responses (54%) to our financial audit questionnaire and 14 responses (65%) to our performance audit questionnaire;
- Comparison and benchmarking;
- Compare internal and external data and evaluate performance for each criteria or terms of reference against internally specified requirements (compliance) and against external approaches (better practice);
- In identifying and raising recommendations we gave due regard to Audit Office's strategic plans, policies, organisational structure, goals, operational management, corporate management and audit service provision; and
- Issues and recommendations were discussed with key Audit Office staff as the review progressed to ensure effective buy in and ownership.

Our review as conducted in accordance with ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information and ASAE 3500 Performance Engagements.

The detailed steps in our methodology as related to the specific terms of reference are set out in the Appendix to this report.

6 Findings and Recommendations

Outlined below are the detailed findings and recommendations based on the results of our review. The findings are based on the results of our work as outlined in Section 6 Methodology and Approach and are laid out in order of the terms of reference in the scope. For each item in scope we have provided a conclusion. Where we believe issues exist, which could be addressed by management action to enhance the process and control framework, these have been highlighted and are accompanied by a recommendation where deemed appropriate.

6.1 Term of Reference One – Auditing Function

A. COMPLIANCE WITH CURRENT PROFESSIONAL STANDARDS AND LEGAL REQUIREMENTS IN UNDERTAKING AUDITING OF ALL TYPES

CONCLUSION:

We are satisfied that the Audit Office materially complies with current professional standards and legal requirements in undertaking auditing of all types.

6.1.1 Financial Audit

As detailed in our approach the review sought to examine whether the Audit Office's financial auditing activities comply with current professional standards and legal requirements. In assessing this, four sub criteria were applied and our findings in relation to each of these are detailed below.

Overall, the review concludes that the Audit Office has in place a robust framework to ensure compliance with all professional and legal requirements. More specific findings are made below which are also accompanied by comments against each of the sub-criteria.

Findings

A summary of the key findings from the results of our work are as follows:

- The Audit Office has in place a robust methodology for ensuring compliance with accounting standards and legislative requirements;
- Audit opinions issued by the Audit Office comply with all applicable professional standards and practices;
- Audits are generally supported by adequate plans, workpapers and audit evidence. A small number of issues were identified during testing where the Audit Office methodology had not been fully complied with. Scope exists to ensure a greater level of compliance and consistency of approach in the future; and
- The Audit Office is enhancing the coverage of its "cold" review process to assist in continual improvement.

Sub-criteria: Whether the Audit Office has in place adequate and appropriate methodology, practices and procedures.

The Audit Office has in place a robust audit methodology which forms a key part of the overall control framework to ensure compliance with professional and legal requirements. The methodology is supported by policies and procedures which are regularly reviewed and readily accessible to staff. The Audit Office Practice Manual is the primary document for policies and procedures. The Audit Standards themselves are also a key source of guidance and the Audit Office intranet contains clear links to websites which may be valuable resources for auditors such as the Institute of Chartered Accountants, CPA Australia and relevant standard setting bodies.

A key feature of the methodology is that it is intrinsically embedded within the software used by the Audit Office to undertake financial audits. This software, AS2, is a product sourced from the accounting firm Deloitte Touche Tohmatsu (Deloitte) and has been used by the Audit Office for a number of years. AS2 is supported on an ongoing basis by Deloitte, who undertake quality assurance processes to ensure that the requirements of accounting standards are captured. Under the current licence agreement which expires in December 2010 updates of the AS2 packs are available every six months.

Issue: The current licence agreement for the Audit Offices AS2 financial audit software supplied by Deloitte is due to expire in December 2010. The lead time on ensuring an appropriate replacement audit enabling software is found, and can be successfully implemented with the follow on changes in methodology, is likely to be in excess of 12 months.

Recommendation #1: The Audit Office implement a project to review the market for appropriate financial audit methodology and enabling software. Consideration should be given to the software used by other comparable jurisdictions.

In addition the Audit Office maintains its own Audit Support team which is tasked with independently reviewing the requirements of accounting standards and assessing the adequacy of controls within AS2. When the new Auditing Standards were introduced in 2007 the AS2 package was not updated by the supplier on a timely basis to incorporate the required changes for the Audit Offices 2007 audit program. This resulted in the Audit Office implementing additional control mechanisms to ensure compliance with the new Auditing Standards was maintained. AS2 was updated for 2008 and the Audit Support Team continues to ensure professional standards are complied with, in the Audit Office's methodology.

Specific Audit Office and public sector requirements are dealt with via a range of forms and glossary of terms designed to compliment AS2, rather than trying to tailor the product directly. These additional elements are maintained by Audit Support.

The Audit Support team also prepares responses to Exposure Drafts put forth by the Australian Accounting Standards Board as part of the due process for proposed changes to accounting treatments. Oakton examined the work undertaken by the Audit Support Team and was able to identify numerous additional controls implemented by the Audit Office to ensure that its methodology is adequate and appropriate.

One of the features of the AS2 product is that it is highly statistical with an emphasis on the substantive testing of balances. The methodology provides clear links between the assessment of risk, the effectiveness of an organisation's controls and the testing of transactions required. All fundamental audit assertions are addressed by the methodology.

Sub-criteria: Whether the audits are supported by adequate plans and work papers, appropriate audit evidence and appropriate quality control procedures

As noted in our methodology and approach section we reviewed thirteen audits from the 2008 year which included one contracted audit and coverage across all of the Financial Audit Branch (FAB) business teams. In relation to four audit clients selected we also reviewed the 2007 year files to enable a comparison between years.

In general, the audits reviewed were well planned, utilising a planning process that is largely driven by AS2 software, as well as by a number of additional planning processes developed independently by the Audit Office. Ensuring compliance with the accounting standards, as well as with any legislative requirements, requires a rigorous planning approach to be commenced early in the yearly audit cycle. The Audit Office's Audit Support division conducts detailed due diligence examinations of standard requirements and their alignment with the planning approach adopted. The review examined the results of these due diligence examinations and found them to be comprehensive.

The Audit Office's approach to the preparation and retention of workpapers is becoming increasingly reliant upon electronic media. Most files reviewed relied heavily on the use of electronic workpapers. The review was satisfied that the electronic workpapers provided a readily accessible record of the audit work undertaken which ultimately supported the audit conclusions reached. Electronic workpapers have many advantages over paper based files, such as being easier to navigate, providing a clear and consistent approach for documenting that all workpapers have been reviewed, and are able to be backed up easily.

In financial audit there will always be some paper based evidence that must be retained and this was the case with the files reviewed. The balance between paper based records and electronic workpapers varied somewhat between audits. It was evident that from 2007 to 2008, the trend was for an increasing reliance on electronic workpapers. The review is of the opinion that the audit trail is simplified where workpapers can be located and reviewed within a single system and our own attempts to test the integrity of the audits were simplified where the use of electronic workpapers was extensive. For this reason the review supports the trend towards an increased reliance of electronic workpapers to be applied consistently across all audits.

It was noted that the planning approach adopted by the Audit Office is highly statistical, with the type of tests to be undertaken, and the size of samples, driven heavily by the AS2 methodology. While these testing approaches can be varied from, this requires clear documenting of the rationale for doing so.

Audits are subject to a robust quality assurance regime comprising of internal checks, as well as some 'hot' and 'cold' review processes. The audit methodology contains a number of key process checklists reviewed by the audit's Engagement Controller, designed to ensure that key audit steps have been properly completed and findings considered. Other key checkpoints include the need to have certain processes approved by the Auditor General or Assistant Auditor General before the audit can progress further. These include approval of the proposed audit fee and "Approval In Principle" of the final opinion to be issued.

The major audits also have assigned an Engagement Reviewer who provides an additional level of checking in addition to that conducted by the Engagement Controller. This is the 'hot' review process and is conducted while the audit is still underway.

While the planning and quality assurances processes are sound in their design, our detailed review of a selection of audit files identified a number of instances where the execution of these showed some deficiencies. These are discussed in the three issues below.

The Audit Office Financial Audit methodology includes a number of checklists and forms that are either embedded within AS2 or are additional Audit Office requirements that are included within the AS2 file structure. Although many of the forms had space for review and approval notification on the form we noted instances where the only evidence of review was in the AS2 index level.

<i>Issue:</i>	Failure to sign off some checklists/recorded approval of documents. Many files contained checklists with provision for internal sign off by the reviewer and the date of review. These were not always completed, although the forms had been signed off at the index level in the AS2 software indicating that the work had been completed. Signing off the actual checklists provided the best evidence of the actual work undertaken.
Recommendation #2:	Reinforce the need to comply with the Audit Office requirements to sign off checks and approvals within current Financial Audit processes Consider reintroduction of Mini Quality and Review Committee (QARC) or revised file completion checklist utilising the existing "status of Forms and Templates" document to assist in ensuring compliance.

Our reviews of the application of the Audit methodology, on our sample of audit files, highlighted differing approaches to the raising and follow up of potential audit issues. Use of differing approaches increases the risk that potential issues could be overlooked or not properly closed out.

<i>Issue:</i>	There exists an opportunity to improve the transparency of workpapers by adopting a more consistent approach to raising potential audit issues and following these through to their resolution. Standardisation will improve audit and audit review efficiency and reduce the likelihood of issues being overlooked.
Recommendation #3:	Promote the use of a standardised approach to raising and resolving potential audit issues throughout workpapers.

Similarly to the point above there were different approaches taken to the documentation and clearing of comments and review points on the sample of audit files we reviewed. However we note a revised process for clearing review points was introduced by the Audit Office last year.

<i>Issue:</i>	Some workpapers appeared incomplete because comments and review points had not been documented as having been addressed and resolved.
Recommendation #4:	Reinforce process for clearing review points in accordance with revised approach adopted by the Audit Office.

In accordance with "APES 320 Quality Control for Firms" the Audit Office undertakes a 'cold review' process under the auspices of its Quality and Review Committee (QARC). The 'cold review' process is currently conducted by recently retired senior audit office staff and is commenced after the audit process has been completed. Results are fed back through the QARC for consideration and action to assist in continuous improvement. During 2007 and 2008 the level of the program was in accordance with APES 320 Quality Control for Firms and aimed to cover all of the Business Team Leader's (BTL's) on a rolling 3 year basis. BTL's head up each of the thirteen Financial Audit Branch Teams which currently perform Financial Audits on behalf of the Audit Office. The timing of the 2007 program meant that it was not completed until more than 12 months after some of the audits subject to review had been completed.

For the 2009 program the Audit Office has increased the number of reviews to cover all BTL's across the annual cycle during 2009 with results expected prior to be communicated prior to 30 June.

<i>Issue:</i>	<p>The Quality and Review Committee (QARC) cold review process is a key method of ensuring consistency and continuous improvement. The level of the program in 2007 and 2008 was in accordance with APES 320 Quality Control for Firms and aimed to cover all BTL's on a rolling 3 yr basis. However the timing of the reviews meant that the results were not available to build into the subsequent years planning processes.</p> <p>Management have increased the number of reviews to cover all Business Team Leader's across the annual cycle during 2009 with results expected prior to be communicated prior to 30 June.</p>
Recommendation #5:	<p>We support current initiative to ensure annual program of QARC reviews covers all Business Teams.</p> <p>We recommend the timing of the review be changed to enable lessons learnt to feed back into the subsequent years planning cycle.</p>

In addition to audits conducted in house the Audit Office outsources approximately 10% by number and value of its audits. The Audit Office has a robust process to appoint firms to undertake audits on their behalf and responsibility remains with the Audit Office for the signing of the Financial Statements.

Following issues raised in a 2008 QARC review of a contract audit, which were supported through our own review work, the Audit Office has reviewed and updated its policy and procedures, including the Contract Audit Agents Manual updated in November 2008. These changes have also been enforced through a training session with the Contract Auditors. The issues which arose highlighted the ability of some of the contracted firms to address all requirements of the new Auditing Standards, however we believe the changes in the processes will assist in ensuring ongoing effective quality and management of this area.

One of the feedback mechanisms employed by the Audit Office, in relation to the quality of service provided by Contract Agents, has been the use of in house surveys for completion by both the Client Agencies and the internal Audit Office Reviewer responsible for the Agency. Our detailed fieldwork revealed a low level of completion and response in relation to these surveys.

Issue:	There has been a poor response rate on the client and Audit Office reviewer in house surveys for Contract Audit agents – approximately 30% over the last three years. Client and Audit Office reviewer response is an important element in overall quality control process.
Recommendation #6:	The Audit Office promote completion of Client and Reviewer Surveys for contracted audits to assist in monitoring and continuous improvement initiatives.

Sub-criteria: Whether the audits are appropriately planned and coordinated

The Audit Office has a well documented methodology for planning audits and this is transparent in the documentation maintained in AS2, as well as by the information retained in paper files.

We note that the matter raised in the 2006 audit regarding the use of Internal Audit work remains largely unchanged. The Office's approach is not to rely on Internal Audit work (which would require further assessment to ascertain the extent to which it can be relied upon) and instead to prefer substantive testing.

The table below summarises the results to a range of questions from our Financial Audit client survey which deal with planning and coordination. For our survey results we have highlighted the dominate response(s) category for ease of reference.

Questions	Answer Options		Strongly Agree		Agree		Neither Agree nor Disagree		Disagree		Strongly Disagree	
The planning process (including Client Service Plan) adequately detailed the scope and approach of the services to be provided by the Audit Office	14%	14	73%	71	8%	8	5%	5	0%	0		
The audit planning appears to have focused on the appropriate risks and issues facing my organisation	8%	8	66%	64	15%	14	11%	11	0%	0		
My organisation was adequately informed of the progress of the audit	5%	5	67%	65	20%	19	8%	8	0%	0		
My organisation was adequately informed of audit issues as they arose	8%	8	65%	63	15%	14	10%	10	2%	2		

The quantified responses in the table above show a very high level of satisfaction with the adequacy of all types communication for Financial Audit planning and ongoing communication on progress.

Some negative ratings and comments were received around the adequacy of audit planning process in identifying relevant business risks and understanding the operations of the client agencies. These were often smaller agencies which were subject to change of either their own operations and/or audit staff.

Balancing this there were a small number of highly complimentary comments about the professionalism and communication skills of individual audit managers, staff and teams.

The majority of Respondents felt that they had been adequately informed on the progress of the audit and on audit issues as they arose. However a portion were neutral or disagreed and the comments received show that some enhancements can be made in this area.

The above results were not dissimilar to those arising out of the Audit Office's own client survey and we are satisfied with the approach taken to feed these results back into the continuous improvement process.

Sub-criteria: Whether the audit opinions issued by the Office comply with applicable professional standards and practices

Australian Accounting Standard ASA 700 establishes the mandatory requirements, and provides explanatory guidance on, the form and content that an auditor's report must adhere to for general purpose financial reports.

The requirements of ASA 700 include the need to state:

- whether the statements represent a true and fair view of the organisation's operations;
- the type of audit opinion able to be issued (an unqualified opinion, a qualified opinion, a disclaimer of opinion, or an adverse opinion) and the circumstances when each of these is appropriate;
- the accounting framework being complied with, as well as whether any legislative requirements have been examined; and
- numerous other presentation issues.

The review examined whether the audit opinions for audits subject to sample testing complied with the professional requirements of ASA700.

Of the audits examined from the 2007 and 2008 years, no instances were identified where the audit opinions expressed failed to comply with the requirements of ASA 700.

In addition we reviewed the process for the issuing of Qualified Audit opinions. The Audit Office has in place a robust process for ensuring appropriate review and consideration is undertaken prior to issue of these opinions and provides a useful analysis of these opinions in its annual report.

No issues or recommendations arose in relation to this sub criteria.

6.1.2 Performance Audit

As detailed in our approach the review sought to examine whether the Audit Office's performance auditing activities comply with current professional standards and legal requirements. In making this assessment we reviewed the methodology for compliance with professional standards and benchmarked application of the methodology against the practices adopted by other jurisdictions. We then examined the application of the Audit Office methodology through a sample of performance audits undertaken during 2007 and 2008.

Overall, the review concludes that the Audit Office has in place a robust framework to ensure compliance with all professional and legal requirements. More specific findings are made below which are also accompanied by comments against each area of the review.

Findings

The Auditor-General has complied with current professional standards and legal requirements in undertaking performance audits, and has specifically:

- implemented adequate and appropriate methodology, practices and procedures to ensure compliance with professional standards; and
- complied with the statutory requirement to avoid comment on matters of Government policy.

Sub-criteria: Whether the Audit Office has in place adequate and appropriate methodology, practices and procedures.

In 2005, the Audit Office adopted the INTOSAI Performance Audit methodology. This methodology forms the basis on which the Audit Office currently conducts its audits. This methodology was employed for the period under review which covers the intervening period from the last Triennial Review in 2006 to date.

Since the last review, the Performance Audit methodology has evolved through a continuous improvement cycle to streamline the application of the framework and has achieved improved efficiency and effectiveness. Key findings include:

- Improved alignment between the methodology and the Australian Auditing Standards;
- Audit objectives are more focused under the 'lines of inquiry' methodology;
- There is a real commitment to establishing collaborative working relationships with client Agencies and the Public Accounts Committee (PAC); and
- Recommendations are now followed up by the PAC which enhances the contribution of the Audit Office to improved accountability and value for money auditing.

Overall the methodology compares well with the Australian Auditing standards and the INTOSAI and ASOSAI Performance Auditing Guidelines.

The Auditor-General's Practice Manual states that detailed comments and guidance on the performance audit function are contained in the Performance Audit Policy, Practice Notes and Checklists, which are available on the Audit Office Intranet. There are a number of Practice Notes for performance audits which form the basis of the performance audit methodology application

Issue: The AG's Practice Manual currently refers to a Performance Audit Policy that does not exist.

Recommendation #7: The AGs Practice Manual needs to be updated to include a 'Performance Audit Policy' that it currently refers to but which does not exist. The Policy should bring together the Audit Offices mandate for performance audit together with the methodology framework for use in all Performance Audits and the alignment with professional standards.

In the review period, the Auditing and Assurance Standards Board (AUASB) issued a standard on Assurance Engagements ASAE 3500 Performance Engagements. The AUASB develops Auditing Standards under section 336 of the Corporations Act 2001 for the purposes of the corporations legislation and formulates auditing and assurance standards for other purposes. This Standard on Assurance Engagements (ASAE) establishes mandatory requirements and provides explanatory guidance for conducting and reporting on performance engagements. This ASAE is operative for performance engagements commencing on or after 1 January 2009. None of our sample audits was required to comply with ASAE 3500, but we did assess the Performance Audit methodology against the new standard to ensure there was nothing within the methodology that may compromise compliance in future audits. The result of this examination identified that the Auditor-General is well placed to ensure compliance with ASAE 3500.

Legislative and Professional Requirements

The Audit Office operates under the Public Finance and Audit Act 183 (the "Act"). Division 2A of the Act specifically deals with Performance Audit and provides the Auditor-General discretion in determining the nature and extent of Performance Audits and reporting requirements. Section 38C provides that the

Auditor-General report to the Head of the Authority, the responsible Minister and the Treasurer as to the result of any Performance Audit and that a maximum of 28 days should be provided for agencies to comment on the report. This section also stipulates that the Auditor-General set out reasons for opinions expressed in the report. Section 38D provides for the Auditor General to present reports to Parliament.

The Australian Accounting Research Foundation, on behalf of CPA Australia and the Institute of Chartered Accountants in Australia has issued two standards relating specifically to Performance Auditing. These are:

- AUS 806 Performance Auditing; and
- AUS 808 Planning Performance Audits.

AUS 806 establishes standards and provides guidance on the objective and general principles governing a Performance Audit. AUS 808 establishes standards and provides guidance on planning a Performance Audit. It is a requirement that it be read in conjunction with AUS 106 and AUS 806.

The Audit Office maintains accreditation against ISO 9001. APES 320 quality control requirements are separate from, but complementary to ISO quality requirements. ISO reviews of audit working papers and processes check for compliance with internal policies and procedures, including the application of APES 320 quality control system policy and procedures. ISO reviews do not evaluate how judgements and conclusions are supported by the audit, which is a requirement of APES 320 monitoring. The two reviews help the Office assure Parliament and agency clients that the Office meets international and professional standards and is continuously improving its activities.

The Performance Audit methodology employed for the period under review was compared against the requirements of the Australian Auditing Standards listed above and the Act. We conclude that the methodology is compliant with the Standards and the Act. Some minor issues were noted in relation to completeness and consistency within the current suite of policy and procedures as detailed below in the subsequent section.

Sub-criteria: Whether the audits are supported by adequate plans and work papers, appropriate audit evidence and appropriate quality control procedures

As previously noted the review approach included the detailed examination of a sample of files to ensure the methodology was utilised effectively and consistently on each of the audit engagements. This review involved detailed assessment of the supporting audit files, discussions with senior members of the Performance Audit teams and detailed review of the tabled report.

In general, the review was satisfied with the audit methodology for each of the audits included for sample testing. Some minor issues arose out of our detailed review across the core audit elements of planning, workpapers /evidence and reporting detailed below:

Planning

As noted above, under the previous sub criteria, the Audit Office performance audit methodology utilises a lines of inquiry approach, however there was limited evidence on how certain lines of inquiry were arrived at with no basis for assessing the pursuit of certain lines of inquiry over others. In addition the risk strategy for assessing lines of inquiry did not appear to be followed in all instances. "Practice Note 4 states – Risk matrix, "the lines of inquiry should be rated as high, medium or low against each selection factor. The topics ranked highly on all or most of these elements will be the most appropriate area for detailed audit inquiry". A paper on the selected lines of inquiry, including the preferred options and analysis table (or risk matrix) must be approved. This is the first formal product required of the audit team but was not evidenced on audit files.

<i>Issue:</i>	Without a formal assessment of the lines of inquiry against the Risk Matrix of potential options for lines of inquiry, the basis for the approach taken to a particular performance audit is weakened.
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Recommendation #8: Formal assessment of the lines of inquiry against the defined Risk Matrix should be conducted in all instances as part of the planning stage of each performance audit

For individual audit plans on specific performance audits, there was no tangible link to the Strategic Audit Plan (SAP). The SAP is the overriding plan for the Audit Office Performance Audit program, its basis is considered further under Section 6.3. There was scope to include this link under the Section 'Expected Benefits' or in Checklist 1 Audit Commencement. Additionally, there was no indication of what government sector was being addressed.

Issue: Audit documentation did not demonstrate a link between the individual planning being undertaken on a specific audit and the overarching Strategic Audit Plan.

Recommendation #9: Individual audit plans should have tangible links to the Strategic Audit Plan and these should be incorporated into the planning documentation at the commencement of the audit.

Workpapers/Evidence

Not all evidence obtained on the audit file cites the 'source' of the evidence – it is essential that workpapers be referenced to source particularly with large audit files as it is difficult to determine what is relevant as supporting evidence and what is "other" background information. ASOSAI Guideline 5.50 states workpapers should be organised and consistent and this should be facilitated by a logical and easy to follow index. Further, 5.51 states that all supporting documentation should be cross referenced to related workpapers and also to the audit plan. It should be noted the Audit Office uses a file structure not a workpapers structure placing more reliance on appropriate referencing of workpapers.

ASOSAI Guideline 5.41 states that workpapers serve as the connecting link between the fieldwork and the report and should be sufficiently complete and detailed to provide an understanding of the audit. In most files, the workpaper structure doesn't necessarily lend itself to a logical flow through from the planning document to fieldwork to the report. Our review was satisfied that the fieldwork was completed appropriately in all instances, and with the focus on the report, it is hard to argue with the logic of the cross referenced report being the 'be all and end all' of the audit. However, in terms of conducting a cold review, such as our own, it is not easy to follow through the logic of testing and ensure the planning criteria have been adequately and appropriately addressed. The quality of the report(s) suggests this may not be an issue as the criteria and lines of inquiry are appropriately concluded against and evidenced.

Performance Audit files would benefit from ensuring all workpapers from an external source cite the appropriate source and that only those workpapers that are necessary to support the final report remain on the key files. These considerations formed part of Recommendation 3 from the 2006 Audit Office review and require continuous diligence and application of Audit Office policy to ensure they are addressed, however the impact of the associated issues is primarily on any cold review process.

In addition a potential opportunity to review the framework arises where an audit is committed to answering the lines of inquiry agreed at the planning phase although these lines may move during the fieldwork phase. This leads to slight inconsistencies between committed lines and reported lines where changes are not formally accounted for. It may even lead to questioning the merits of continuing an audit where early inquiry deems it inefficient to do so.

The areas discussed above increases the importance of the HOT Review process used on all reviews. The HOT review is an important control in managing issues that arise during the audit where an independent, experienced practitioner can provide guidance to address issues that may compromise the effectiveness of the audit, whilst the audit is in progress. There was limited guidance to advise staff of the processes and procedures required for the HOT review to make a positive contribution to the audit.

Issue: Process and requirements around the current HOT review process is limited. This may impact the quality of the final product.

Recommendation #10: The roles of the HOT Reviewer to be further defined and to include:

- A mandated responsibility to sign off that the audit approach complies with the internal methodology;
- Ensuring that the question posed by the audit aligns with the conclusions reached and that this is consistent with the planned objective; and
- Ensuring that lines of inquiry have been properly pursued and that the reason behind any divergences from these is transparent in working papers

Staff undertaking the "HOT" reviewer role need to be well trained in the use of the Audit Office's internal methodology and be aware of likely issues of compliance.

While the Hot Review is an end of process control, which occurs prior to the completion of the audit, the Weekly Status Report is an important means of advising the audit manager of issues as they arise throughout the audit. Early intervention is often important to manage a situation before it becomes unmanageable or has a bigger impact than it necessarily needs to have. The Weekly Status Report contributes to effective management of the audit, but review of the audit files indicated that Status Reports were completed irregularly in some instances, leaving gaps in the chronological history of the audit.

Issue: The weekly status report is an important means of advising the audit manager of issues as they arise throughout the audit. It is an important compensatory control (for Audit Office management) that ensures all planning criteria have been addressed in those instances where the audit trail from the audit plan to the fieldwork conducted is not particularly clear. Our review noted some gaps in the provision of weekly status reports.

Recommendation #11 The importance of the weekly report be enforced through mandated adherence to policy.

Successful management of the audit requires all risks to the audit process to be managed effectively. The Audit Office completed a comprehensive risk assessment at the start of each audit we reviewed. However this document became a static document rather being a means of ensuring expected risks either did not materialise or were mitigated effectively. There was no evidence the risk strategy had been revisited to gauge whether there were risks realised or unrealised that impacted the audit process.

Issue: There was no tangible evidence of how the Risk Management Strategy, which is completed as part of the audit planning process, is revisited during the audit along with analysis of whether risks were realised fed into process improvement. The Strategy covers both audit process and risks related to the audits objectives. It is likely that during the course of the audit risks may be realised and new strategies or changes in methodology adopted to mitigate the risks.

Recommendation #12: The Audit Scorecard, which provides an internal assessment at completion of the audit, should be expanded to incorporate an assessment against the Risk Management Strategy, to ensure contingent issues identified in the planning stage are satisfied throughout the course of the audit and provide appropriate closure.

Reporting

The tabled reports generally reflected the agreed objectives and scope and criteria.

However instances were identified where the report did not align with audit plan in terms of the lines of inquiry and the audit criteria. There was no evidence that changes had been agreed with the Client Agency and in one instance there was a change in the reported line of inquiry that could have been perceived as a change in audit scope. The nature of performance audit means there will be on occasion legitimate need to change the scope of an audit after commencement. We note that in February 2008 the Audit Office updated Practice Note 11 – liaising with the Agency to ensure the changes are endorsed by the Assistant Auditor-General and advised to the client immediately. Hence we have not raised a recommendation in relation to this issue. Although we have noted below ways to further enhance the process and minimise associated risks.

<i>Issue:</i>	Some instances were identified where the lines of inquiry provided in the final report varied slightly from the lines of inquiry in the planning documentation. In one instances the variation suggested to the reader that the audit may have represented a change in scope.
Recommendation #13:	It is recommended that the clearance process for reports include provision that there has been reconciliation between planned audit objectives, criteria, scope, lines of inquiry and the audit objectives, criteria, scope and lines of inquiry published in the final report.

Further the nature of the audit opinions provided in the final reports examined was not always clear, since the audit opinion was not always a specific statement against the audit objective. The key issue being that there was not always a definitive statement on whether the audit objective had actually been achieved.

<i>Issue:</i>	In some instances the audit opinion was not a specific statement against the audit objective and while there was an implied opinion, there was no definitive statement to satisfy the reader that the audit objective had actually been achieved.
Recommendation #14:	Opinions in the published report must address the primary objective of the audit. Contextual discussion supporting the opinion must specifically address each line of enquiry to ensure the report is structured in a manner that is consistent with the audit plan.

Benchmarking/Peer Review

As part of their continuous improvement process, the Audit Office arranged for a peer review of their Performance Audit methodology in 2008 by members of the New Zealand and Western Australian Audit Offices. The focus of the peer review was to examine a sample of audit files against 12 key requirements of Section 4.2 of the Australasian Council of Auditors General (ACAG) Governance and Audit Standards for Self Assessment and External Review. The peer review concluded that the audits reviewed 'were high quality, examining valuable topics using sound approaches and making useful recommendations.' While some minor issues were identified with compliance against ACAG 4.2, they were 'easily addressed and did not affect the quality of the performance audits examined.'

Suggested areas of improvement from the peer review included:

- Better focusing of audit topics through the topic selection process;
- Assessing and explaining the reliability of data used in reports;

- Clearer expression of audit opinions and lines of inquiry, and
- Strengthening the capture of information on the post-tabling impact of reports.

With regard to ACAG 4.2, three areas were identified where compliance could be improved. These included:

- Better evidence that the skills, competence and knowledge of the audit team had been assessed against the needs of the engagement;
- Better evidence in the audit plan of early consideration of the likely size and structure of the audit report, and
- Better evidence to demonstrate that the audit team developed an adequate understanding of the subject area and that formal consideration had been given to the suitability of the audit criteria.

The findings of the peer review are in line with our own review findings and we support the efforts of the Audit Office to have peer reviews conducted, and participate in peer reviews in other jurisdictions, on a regular basis. We also analysed the Audit Office methodology in discussions other jurisdictions and are satisfied that in many areas the Audit Office can demonstrate leading practice.

6.1.3 Compliance Audit

As noted in our approach there have been no Compliance Audits carried out since 2006. This was primarily due to a transfer in financial audit resources in dealing with the impact of the new Auditing Standards. However during the course of our review the Audit Office were developing a limited compliance audit program for application in 2009 as such we were only able to assess the initial sub criteria noted below.

Findings

The review concluded that the new Compliance Audit framework to be adopted by the Audit Office is in accordance with professional standards.

Sub-criteria: Whether the Audit Office has in place adequate and appropriate methodology, practices and procedures.

The new Auditing and Assurance Standards Board Standard on Assurance Engagements, ASAE 3100 Compliance Engagements, is operative from October 2008 and a new compliance audit framework designed in reference to ASAE 3100 was developed by the NSW Audit Office during our review. It references the various mandatory requirements which are bolded in the standard. The standard states that "ASAE 3100 has been developed as an adjunct standard to ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historic Financial Information. Consistent with ASAE 3000, ASAE 3100 is directed towards the conduct of both compliance audit and compliance review engagements".

6.2 Term of Reference Two – Costs and Charges

A. WHETHER THE AUDIT OFFICE IS PROVIDING VALUE FOR MONEY FINANCIAL AUDIT SERVICES IN COMPARISON WITH THE SERVICES AND FEES OF SIMILAR ORGANISATIONS

CONCLUSION:

We are satisfied that the Audit Office is providing value for money financial audit services in comparison with the services and fees of similar organisations.

Findings

Whether audit fees charged for financial audit are reasonable depends on how the fees are calculated and what the client is charged for. The reasonableness of the fees may be assessed by measuring the Audit Office's fees against benchmarks. Comparable fees for similar services, the method of calculation of the fees charged by the NSW Audit Office and the levels of productivity and efficiency within the Audit Office which impact the fee structure can be used to determine reasonableness.

As detailed in our approach, the review sought to examine whether the Audit Office was providing value for money financial audit services in comparison with the services and fees of similar organisations. We considered the following four elements in relation to this objective:

- We reviewed the Audit Office's process for setting fees for Financial Audit services and understand any key assumptions including any differences across sectors;
- We gained an understanding of the differing reporting requirements of the public and private sector and the impact upon price basis, together with the effect of changes in requirements such as the new Auditing Standards;
- We reviewed published financial statements, identified and compared audit fees of comparable public sector agencies both within NSW and other States and by private sector organisations; and
- We reviewed the results of client interviews, our client survey and the client surveys initiated through the Audit Office.

Our findings in relation to these elements are detailed below.

Fee Setting Process

Fees for individual audits are set on an annual basis as part of the planning process. The fees are set using standard charge rates applied to resource budgets based on prior year actuals, audit team structure and known changes in the agency and its audit requirements. A policy is in place to ensure independent review and approval of all fee changes in excess of 5%. We tested adherence to this policy as part of our work without any exceptions noted.

In addition we reviewed budget fees vs actual costs across a range of agencies to ensure there was no significant systematic cross subsidisation occurring. The results of this work supported the assertion that fees are appropriately set to match the costs of providing the service to specific Agencies.

Charge out rates are reviewed at a global level on an annual basis as part of the overall Audit Office budgeting process. Based on costs and expected chargeable hours the Audit Office sets rates with a view to maintaining a breakeven position over the medium term. As reporting in the Audit Office 2008 annual report over the five years to 2007-08 the cumulative surplus of \$6.2 million (4.8% of turnover) was above the break even target. The Audit Office has put in place mechanisms through its budgeting and charging processes aimed at bringing the surplus back in line with the breakeven position.

Benchmarking of Audit Fees

We undertook a review of fees and rates charged by the NSW Audit Office across a range of key agencies, and compared those rates to fees charged by the Queensland and Victorian Audit Offices for similar agencies. This analysis took into account gross fees, staff numbers and annual audit fees.

Whilst there was a wide variation in the results of the analysis it did reveal a trend which would suggest the Audit Office was providing value for money. Our analysis supports our opinion that the fees for Financial Audits conducted by the NSW Audit Office are not consistently higher or lower than fees charged by other state Audit Offices for agencies of similar size and function.

Impact of Public Sector Requirements and Auditing Standards

We examined the impact on fees set by the NSW Audit Office as a result of the change in Auditing Standards which occurred during the period under review. The increase in fees set by the NSW Audit Office (approximately 8% - 10% over four years) was assessed as being at the lower end of publicly available information (increases ranging from 10%-30%).

The impact of reporting requirements under the Act, including timeframes adds a certain additional resource and fee requirement which is most keenly felt by smaller agencies (refer client survey results below) as the additional requirements do not vary proportional to agency size.

Client Survey Results

The Audit Office conducts a comprehensive Financial Audit client survey each year through a third party provider. A number of elements are used to assist in assessing value in relation to Financial Audit Services and these are summarised as aggregate performance indices which revealed in 2008 satisfaction with audit value of 68%.

This is broadly in line with the results of our financial audit client survey as indicated in the table below:

Value for Money questions	Answer Options		Strongly Agree		Agree		Neither Agree nor Disagree		Disagree		Strongly Disagree	
	%	Count	%	Count	%	Count	%	Count	%	Count	%	Count
The Audit Office provides value for money financial audit services	6%	6	47%	46	28%	27	14%	14	5%	5		
The Audit Office provides value for money financial audit services in comparison to other professional service providers	8%	8	34%	33	37%	36	13%	12	6%	6		
The Management Letter issued upon completion of the financial audit services added value to my organisation	6%	6	54%	51	32%	30	4%	4	2%	2		

The Survey responses for Value for Money questions were the least favourable, of all questions asked, for the Audit Office. Approximately a third to a quarter of respondents were neutral on the Value for Money of Audit Office Financial Audit services balanced against half with a positive perspective. However this may likely be put down to the deemed impost of having an audit conducted.

The additional comments received revealed that those most dissatisfied were smaller entities, with less than 100 employees and appropriation/revenue less than \$10m, who queried the value of the Financial Audit compared to the cost and management effort required to educate less experienced Audit Office staff on their business operations. Staff structure and career progression in the Audit Office means this is often the case for smaller entities. In addition, the legislative structure means that smaller Government agencies are likely to be under more audit resource pressure than similar private sector entities.

The results we received to our own client survey were similar to those gained from the Audit Office client survey in this area. Whilst the Audit Office does have a process for ensuring these issues feed back into continuous improvement, there is probably limited scope for the Audit Office to address the root cause of some of this dissatisfaction.

It should be noted that some favourable comments were received from larger agencies on the value for money proposition.

There are no recommendations in relation to this area.

B. WHETHER PERFORMANCE AUDITS PROVIDE VALUE FOR MONEY BY MEETING THEIR OBJECTIVES AND CONTRIBUTING TO IMPROVED ACCOUNTABILITY BY AGENCIES WITHIN NEW SOUTH WALES

CONCLUSION:

Performance Audits are increasingly providing value for money by delivering against objectives and enhancing accountability through improved administrative practices, increased transparency of process and supporting the role of the PAC.

Findings

Value for money is a subjective concept and means different things to different people. While value for money is about weighing up the benefits obtained from a service against the cost of the service, the client Agency subject to scrutiny is not the Agency making the value for money judgement in the case of a Performance Audit. Client Agencies do not fund the audit program but receive the planned benefits of improved accountability. The latter concept of improved accountability is more defined whereby the role of the PAC is enhanced by leveraging off the audit recommendations to make public administration more transparent and accountable.

Our review has shown that the Audit Office continually seeks to improve the way they conduct their business. Tracking the various changes in their Performance Audit methodology over a number of years indicates a drive for continuous improvement and focus on improving the efficiency of conducting these large scale audits. Whether this has provided improved value for money will depend on the perception of the Parliament, the client Agencies and the general public.

To achieve some measure of whether value for money principles are being achieved, the Audit Office commissions an independent researcher to survey the satisfaction levels of Members of Parliament and Agency Heads on a biennial basis. The latest survey was conducted in 2008. Our audit supplemented the results of the research survey with our own survey of selected Agencies subject to Audit. Analysing the latest survey results against results in prior periods indicates an overwhelming increase in the level of satisfaction with audit reports and outputs. Coupled with our own analysis of the increasing efficiency of audit processes and the determination that audits are being conducted in accordance with defined scope and objectives, the indications are that the Performance Audits are increasingly providing value for money.

It should also be noted that the Audit Office has implemented a new process to truncate an audit where the lines of inquiry are not yielding a significant return against the audit objective and the process of early termination ensures audits are not pursued where the value for money concept is compromised. We support this initiative.

None of the surveys conducted address the issue of audit costs. This is appropriate because the Agency is not funding the cost of the audit. Where the Parliament (via NSW Treasury) provides direct appropriation to the Audit Office, they are not in a position to assess output benefits against input costs because they are not the focus of the auditable area being reviewed. In this regard the inputs and outputs are mutually exclusive and therefore cannot be used as a basis for determining value for money.

The qualitative survey data is therefore an important value for money measure. The 2008 survey results for Performance Audit indicated a positive trend in all measurement areas. On average, 2008 respondents viewed the performance of the Audit Office more favourably than in previous years, in terms of the

- quality of the performance audit process;
- quality of audit reporting;
- value of the performance audit services, and
- overall performance.

Overall, client's attitudes towards the value of the audit in 2008 have shown improvement since 2007, with respondents to the Audit Offices survey stating that:

- the audit would improve administration of the audited activity (75%, up from 67% in 2007 – no clients disagreed with this statement in 2008, compared to 13% in 2007); and
- the audit was valuable in providing a sense of assurance regarding the administration of the audited activity (63%, up from 60%).

Respondents were positive in their commentary in regards to the Performance Audit. The survey highlighted two key focus areas for continuing improvement, particularly the integration of client feedback into the conduct of the audit and ensuring audit teams include experienced audit staff.

These issues have already been identified and managed by the Audit Office. The 'lines of inquiry' audit approach engages clients early in the planning phase of the audit to enable feedback to be integrated into

the audit approach. And while there is limited resources in the Performance Audit Branch, staff overcome the need to be industry specialists by maintaining watching briefs over the industry to be familiar with recent activity within each industry and engage external subject matter experts where specialist expertise is required to complement the general audit skillset.

Performance Measurement

The Performance Audit Branch has adopted and refined various performance measures which are included in the annual Operating Plan. With regard to value for money concepts, the Audit Office has some key indicators to monitor their performance including:

- Agencies agree that performance audits add value, are conducted to high standards of professionalism, make fair and reasonable findings and produce useful recommendations;
- Percentage of recommendations accepted by Agencies; and
- Parliamentarians agree that performance audits facilitate greater accountability in the use of taxpayers money; address issues of significance and provide relevant and useful information.

The measures are internal indicators that have appropriate targets and Performance Audit Branch strategies that demonstrate the Audit Office has an ongoing commitment to getting things right and ensuring the impact of the performance audit program is value for money focused and targets improved accountability for public administration.

Client Agency representatives we surveyed as part of this review provided positive or neutral statements against the following criteria, with only minor disagreement noted:

- the Performance Audit provided Value for Money by meeting its objectives stated in the scope/terms of reference (72% either agreed or strongly agreed, 21% neither agreed or disagreed).
- the Performance Audit provided Value for Money by contributing to improved accountability by my organisation (42% either agreed or strongly agreed, 43% neither agreed nor disagreed).
- the recommendations of the Performance Audit provided Value for Money by improving the operations and/or internal controls of my organisation (57% either agreed or strongly agreed, 29% neither agreed or disagreed).

The above results mirror the results of similar questions asking in the Audit Office's own survey.

In terms of improved accountability across the public sector, our survey results indicate the contribution of the Audit Office is positive. Only 1 in 14 respondents indicated that accountability was not improved through the Performance Audit process.

The change in process whereby the PAC now conducts follow-up reviews of Performance Audit recommendations means the value of the audit product is enhanced by supporting the role of the PAC to scrutinise the actions of the Executive Branch of Government on behalf of the Legislative Assembly and recommend improvements to the efficiency and effectiveness of government activities. However we note that at present the results of the follow up are not formally fed back into the Audit Office's SAP processes. This is an important element to ensure an optimal Performance Audit program, and hopefully value for money, is maintained.

<i>Issue:</i>	The new role of the PAC as the body responsible for following up the implementation of audit recommendations is a significant improvement in the Audit Office's ability to promote greater accountability. To enhance this process, the findings of the PAC follow up should be formally fed back into the Audit Offices Strategic Audit Planning process.
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Recommendation #15: Follow up reviews conducted by the PAC should be formally fed back to the Auditor General to inform the Strategic Audit Planning process.

We endorse the framework used by the Audit Office to achieve value for money concepts and improved accountability in public administration. We encourage the continued use of the following initiatives:

- Independent surveys of Parliamentarians and Clients;
- Peer reviews;
- Benchmarking with other Audit Offices; and
- Management of performance.

6.3 Term of Reference Three - Planning

A. WHETHER THE PROCESS OF SELECTING TOPICS FOR PERFORMANCE AND COMPLIANCE AUDITS IS BASED ON A ROBUST METHODOLOGY INCLUDING A CONSIDERATION OF WHOLE OF GOVERNMENT RISK MANAGEMENT AND CENTRAL AGENCY PRIORITIES

CONCLUSION:

The process of selecting topics for performance and compliance audits is based on a robust methodology including a consideration of whole of government risk and central agency priorities.

It should be noted that as there is no overarching or consistent approach to risk management across NSW Government, the approach taken by the Audit Office is to rely primarily on its own appreciation and understanding of risk across the Governments core performance areas.

Findings

Section 38 B (1) of the Act provides that the Auditor-General may, when the Auditor-General considers it appropriate to do so, conduct an audit of all or any of the particular activities of an Authority to determine whether the Authority is carrying out those activities effectively and doing so economically and efficiently and in compliance with all relevant laws. The decision to conduct a Performance Audit is ultimately up to the discretion of the Auditor-General and there would not necessarily be any requirement in terms of complying with the Act for the Auditor-General to engage any particular methodology in making these choices.

Strategic Planning Process Overview

In 2004 the Audit Office introduced a 3 year strategic planning process which sets out the framework for classifying government activity on a performance outcome basis. The Strategic Audit Plan (SAP) remains the cornerstone of Audit Office planning with balanced coverage across industries based on the whole of government risk assessment and central agency priorities.

For the 2008 year the Audit Office introduced a "whole of office" SAP process combining the efforts of the Performance Audit and Financial Audit branches. Special Interest Groups (SIG's) have been formed which include members from both Financial and Performance Audit who meet to monitor risks and issues in their various government sectors.

The SAP and the SIG's are aligned across the seven performance areas of the State Plan being:

- Law, Order and Public Safety;
- Transport;
- Education;
- Environment;
- Governance and Public Sector Management,
- Public Infrastructure; and
- Health and Welfare;

Together with an additional area split out of Financial Management.

Each year the Audit Office continues to seek suggestions for future audit topics from Members of Parliament and key agency CEO's. The Audit Office develops the program of specific topics for the year by:

- Compiling an initial inventory of the suggestions received and initially mapping the suggestions against strategic performance areas (considering the level of past and potential future coverage);
- Examining how the suggestions align with key performance-related issues to identify specific new audit topics; and
- Checking if the strategic framework needs any modification and finalising the common focus with Financial Audit Branch.

A key document is the issues database. This database records the issues identified by stakeholders for consideration as audit topics. It shows the issue, the source, and whether an audit was in fact carried out. New suggestions are added to the database as they are received. Once issues have been recorded in the database they are not deleted or altered. The issues database is updated each year to include whether the matter has been dealt with via a performance audit, financial audit or compliance audit.

Topics are assessed and analysed, including a split into Performance or Compliance Audit initiatives through:

- Discussion by Audit Office Senior management represented by the Engagement Controllers;
- The Audit Office Executive then approves the topics selected; and
- Auditor-General approves final plan.

The strategic approach identifies key performance areas for a three-year period and annual performance audit projects are identified within this overall program. The concept underlying this methodology is the selection of:

- Key target areas/issues for attention over a three-year period; and
- An achievable number of audits (both new and follow-up) that can be produced each year.

Factors considered include:

- Level of interest by the Parliament and the public;
- Potential social, environmental and financial risks to the community;
- Potential for improved resource/financial management; and
- Potential for enhanced accountability.

This provides:

- A focus on problems to be addressed and/or improvements to be generated;
- A framework to remove subjectivity when selecting performance audit work; and
- A framework for the performance and compliance related work of both the Financial Audit branch and the Performance Audit branch.

The Strategic Audit Plan is not a true risk based management tool as it does not prioritise auditable areas on an evaluation of likelihood and consequence of risk based issues.

Potential audit topics identified through this process could also be substituted at any time on the basis that the Auditor-General decides that an audit should be conducted in the best interest of government or the general public. Should this be the case, a scheduled audit will be withdrawn or delayed at the discretion

of the Auditor-General. Our review did not find any evidence this process is formalised and the rolling three year plan re-prioritised to ensure a previously scheduled audit takes precedence of other audits identified for future delivery.

<i>Issue:</i>	<p>It was noted that some audits commenced during the year did not stem from the planning process conducted but were initiated from other sources. Existing processes do not document consideration of the merits of commencing these audits against others marked for completion. Commencing audits which have not arisen from the agreed planning processes renders part of planning redundant and may result in an inefficient use of resources.</p>
Recommendation#16:	<p>The Strategic Audit Planning process should be broadened to reflect discretionary 'unplanned' audits which arise during the current period. These changes should be published in a revised SAP on the agency website.</p> <p>The Audit Office commit to a rolling three year strategic audit plan which is updated regularly to make explicit the implications of commencing previously unplanned audits and to reflect segment and industry coverage over the period</p>

The Planning approach utilised by the Audit Office compares favourably with audit methodologies in other jurisdictions. There is no standardised approach to creating an audit program and the means by which other jurisdictions conduct their planning varies according to the environment and the direction of the particular Auditor-General. Each Auditor-General has a discretionary right to adhere to the audit plan or to vary the plan as circumstances dictate. Discussions with the Audit Office suggested that a change in Auditor-General can also lead to a change in the way a strategic plan is developed, if it is developed at all. The Strategic Audit Plan is used to guide the process of ensuring appropriate industry coverage and key risk areas are addressed. The Auditor-General retains the right to dispense with the process at any time.

Client agencies surveyed for the review acknowledged their input to the planning process for individual audits. From a strategic viewpoint, the Agencies confirmed that:

- the selection of topics for review suggests the Audit Office process for selecting topics for performance audits appears to be based on a robust methodology (in all but one case), and
- the methodology appears to consider a whole-of-government risk management perspective and central agency priorities (in all but one case).

*B. WHETHER THE SELECTION OF AGENCIES FOR INCLUSION IN COMPLIANCE AUDITS IS ROBUST AND
BASED ON A CONSIDERATION OF THE PARTICULAR RISKS OF THAT AGENCY*

CONCLUSION:

As part of the renewal of the Compliance Audit program we believe there is opportunity for the Audit Office to enhance the framework for the inclusion of agencies within the compliance audit program.

The nature of the Compliance audit program means that topics are selected on “whole of government risk” rather than agency risk profiles. Hence the selection of an agency for inclusion should be based on it being a risk for that agency rather than the overall risk profile for the agency.

Findings

As previously noted no separate compliance audit program was conducted during 2007 and 2008. During our review a new compliance audit framework was developed for the 2009 program. This programme is to consist of two audit topics including one on Total Asset Management (TAM)

Discussions with the Audit Office revealed that the agencies selected for review in respect of the Total Asset Management have initially been selected off the list of twentysix Nominated Government Agencies which have been designated by NSW Treasury for the purposes of Total Asset Management Reporting. Nominated Agencies generally are agencies with large asset portfolios or capital programs. They are required under the Total Asset Management requirements² to provide specific reports such as Asset Strategy and reports against specific maintenance measures. Other agencies, who are not nominated agencies, have lesser asset reporting requirements.

The Audit Office selected ten of the agencies for the TAM compliance review on the basis of one nominated agency for each Financial Audit Business Team, who audit those agencies. Further client agencies were then chosen for the Teams that did not have a client on the nominated list. Although this will enable the smoothing of workload and experience across all Financial Audit Business teams it will not necessarily provide a representative cross government risk profile in relation to TAM.

<i>Issue:</i>	The selection of agencies for inclusion in the initial 2009 TAM Compliance audit program has been based on a list of affected agencies and then smoothing coverage across Business Teams. This may result in a sample selection that does not reflect a cross section of Government’s risk profile in relation to the particular compliance risk subject to audit.
Recommendation #17:	Selection of agencies for inclusion within compliance audits should primarily be based on ensuring an appropriate representation across the Governments risk profile in relation to the compliance risk subject to audit. We suggest the new Compliance Audit Framework is amended to provide guidance on agency selection.

² Tpp 08-2 Total Asset management(TAM) requirements for updating the NSW SIS issued by the Office of Financial Management.

6.4 Term of Reference Four – Management and Resources

A. WHETHER THE AUDIT OFFICE HAS ADEQUATE RESOURCES TO CONDUCT IT'S FUNCTIONS

CONCLUSION:

We are satisfied that the Audit Office has adequate management and resources to perform its core function of Financial Audit in terms of legislative and professional requirements.

Audit Office resources in relation to performance audit are largely determined by the appropriation received from the Parliament (via NSW Treasury) to enable completion of the annual performance audit plan. As each years plan is substantially completed then resourcing can be deemed as adequate.

Findings

In addressing this objective we reviewed performance and operations of the Audit Office in terms of past, current and future performance, budgets and funding plans and identified trends of key resources and indicators including:

- Staff – FTE numbers, organisational mix, remuneration; retention, development and training;
- Overheads including premises, IT software and hardware infrastructure;
- Access to specialists / experts;
- Funding; and
- Performance benchmarks as reported in the Audit Office Annual Report.

Where available we obtained data from similar organisations and compared and analysed results. Our analysis was based upon both quantitative and qualitative data.

Staffing

Staffing numbers have increased during the three year period to 2009, with what is generally considered an optimal level of staffing achieved during 2009 though the ability to attract permanent staff into the Financial Audit area. Our analysis of the skills, experience and qualifications of staff indicates that the Audit Office appears to be successfully addressing the need to attract and retain skilled and experienced staff members. This was previously an issue of concern.

In addition the current economic situation puts the Audit Office in a good position to attract and retain staff due to current uncertainties in the private sector. This will result in a decreased need to rely on a level of contractors during the financial audit busy season (June-September), which had occurred in prior years.

As part of our review, we examined and discussed Human Resource policies and procedures, training schedules and notes and induction processes. The Audit Office has in place a comprehensive staff performance monitoring and development program which is subject to continued enhancement.

A comprehensive annual staff survey³ is undertaken. Results of this survey have consistently reflected strong levels of employee satisfaction (2007 – 76%, 2008 78%) and morale (2007 – 74% and 2008 – 81%).

The nature of the accounting profession means there is ongoing churn and quick development in the early years of an accounting professional's life and the experiences of the Audit Office appear as expected.

³ Staff Survey as reported in 2007/08 Annual Report

Overheads and Technology

Prior to the commencement of our fieldwork the audit office undertook a major technology upgrade which will assist in the delivery of efficient audit services in the future. A key challenge moving forward may be the requirement to replace their Audit enabling software AS2 when the current licence expires in December 2010, as has been mentioned previously in this Report.

Other overheads in terms of office accommodation are in line with expectations for an organisation the size of the Audit Office and appear effectively managed.

Access to Specialists and Outsourcing

The use of experts and specialists is not extensive within the Audit Office due to the size and experience of the workforce. In relation to Financial Audit an element of the Outsourced program seeks to benefit from the specialist expertise in the Big Four firms such as Superannuation. Specialists are often used of Performance Audits, however these are for discrete areas of the assignments and appears well managed. Occasionally experts may be used for special reviews, such as the 2008 Oversight of Electricity Industry Restructuring.

Funding

Primary funding for the Audit Office is through the audit fees it charges its clients for Financial Audit services (2008 - \$28 million). These have been discussed in Section 6.2 above.

In addition the Audit Office received appropriation from the Parliament for the Auditor-General's reports to Parliament (2008 - \$1.46 million) and Performance Audit (2008 - \$4 million). The separate funding for these items enables clear disclosure and avoids the need for cross subsidisation.

Historically the Compliance Audit program, as performed in the year 2006 and before, has been funded from Financial Audit fees. As part of the reintroduction of the Compliance Audit Program the Audit Office is seeking a changing in the funding structure.

<i>Issue:</i>	As part of the reintroduction of Compliance Audit program the Audit Office is in the process of seeking separate funding from NSW Treasury.
Recommendation #18:	We support the Audit Offices initiative of seeking separate funding for its Compliance Audit program. The office should seek that the program becomes fully funded to avoid potential issues with cross subsidisation with Financial Audit.

Client Views

In addition to our internal analysis we also asked Financial Audit clients during our interviews and client survey questions in relation to the resources of the audit office. A summary of the responses to our survey questions is as follows:

Questions	Strongly Agree		Agree		Neither Agree nor Disagree		Disagree		Strongly Disagree	
	%	Count	%	Count	%	Count	%	Count	%	Count
The Audit Office has adequate resources to conduct its function	1%	1	54%	52	29%	28	14%	13	2%	2
The auditors performing services for my organisation demonstrated appropriate skills and experience	4%	4	67%	64	19%	18	9%	9	1%	1

While the majority of respondents felt Audit Office resources were adequate a significant portion was understandably neutral in this regard, possible reflecting the consideration that the Audit Office has a

statutory mandate and it is not their position to comment on the adequacy or otherwise of how this is discharged.

The additional comments received shed light on this aspect with some concerns about limited timeframes in the year end audit phase, reliance on contract auditors by the Audit Office and lack of supervision of junior or contract staff on smaller agency jobs. A small number of comments felt that Audit Office resources were inadequate.

The quantified responses in the table above suggest a generally favourable perspective on the skills and experience of the auditors performing services. However a minority provided unfavourable comments about the skills, experience, turnover and supervision of junior, new or contract staff. These perspectives related primarily to smaller agencies, who also provided negative comments in respect of value for money so these issues may be linked.

As noted under staffing above the nature of the Financial Audit profession in relation to staff development and previous reliance on contractors exacerbates the issues. However as these results are similar to the Audit Offices own client surveys we are confident that specific issues raised are being fed back into the continuous improvement process to be dealt with where possible.

B. WHETHER APPROPRIATELY SKILLED STAFF ARE UNDERTAKING PERFORMANCE AUDITS

CONCLUSION:

The results of our detailed review of a sample of performance audits and our client surveys supports the view that appropriately skilled staff are undertaking Performance Audits.

Findings

The Audit Office has a range of staff with varying degrees of experience. Staff are allocated to audits based on availability, experience and aptitude for the subject matter. This is not to say the auditors have relevant industry experience, but staff are generally experienced in the conduct of Performance Audits. Where specialist experience or specific industry expertise is required, the Audit Office engages subject matter experts to supplement the generalist Performance Audit staff. The appointment of subject matter experts is subject to a robust assessment methodology that is considered as part of the planning approach. The review of Performance Audit files indicated that subject matter experts were appointed appropriately and their performance on the audit monitored and evaluated and fed back into the Audit Scorecard used to close the audit process. Where performance is unsatisfactory, there are sufficient communication protocols to ensure the subject matter expert is not employed on other Performance Audits.

Staff are not employed as industry experts, rather they are employed as being able to conduct Performance Audits. The training and support provided by the Audit Office ensures staff are conversant with professional auditing standards and the internal Performance Audit methodology.

The quality assurance process that measures the delivery of Performance Audits against professional standards, and the peer review process conducted by staff from other jurisdictions, provides additional assurance that staff have the appropriate skills to conduct Performance Audits effectively.

The Client agency representatives we surveyed as part of this review provided general positive statements against the following criteria, with only minor disagreement noted:

- Audit Office staff undertaking the Performance Audit appeared to have appropriate skills and experience to deliver the service (85% either agreed or strongly agreed);

- Audit Office staff undertaking the Performance Audit appeared to have allocated appropriate resources to undertake the audit (time, coverage, access to experts, facilities etc.) (93% either agreed or strongly agreed), and
- Audit Office staff demonstrated an adequate understanding of the specific subject matter addressed by the Performance Audit (78% either agreed or strongly agreed).

The Audit Office Performance Audit Methodology includes provision in the planning phase to identify opportunities for “on the job” staff development through the Development plan. These opportunities are incorporated into the planning documentation so that they may be managed through the execution of the audit. This is an important means of identifying areas of performance improvement and developing staff training and learning plans to ensure skills are developed and maintained. This planning document is not revisited in closing out the audit process to ensure that the learning and development opportunities have been acted upon.

An additional source of staff development requirements is feedback from the independent clients surveys undertaken on behalf of the Audit Office. Whilst we noted that many of the audit clients surveyed over the passed two years had given authority for the results to be passed back to the Audit Office, the loop to feed back results and comments to individuals for staff performance and development purposes had not been completed on a timely basis.

<i>Issue:</i>	<p>There was no tangible evidence sighted of how the audit Development Plan, which is part of the Performance Audit planning process and highlights areas for on the job development, feeds back into staff development.</p> <p>In addition we noted there appeared to have been only limited access to the available client surveys for use in consideration of staff performance and development.</p>
Recommendation #19:	<p>The Audit Scorecard, which provides an internal assessment at the completion of the audit, should be expanded to incorporate an assessment against the Development Plans to ensure issues identified in the planning stage are satisfied throughout the course of the audit and provided appropriate feedback to audit staff where necessary.</p> <p>The practice of disseminating the performance audit client surveys should also be enhanced to ensure timely feedback is provided where possible to feed into staff development.</p>

6.5 Term of Reference Five – Communication with Clients

EFFECTIVE COMMUNICATION WITH CLIENTS IN PARTICULAR IN RELATION TO:

A. ESTABLISHING A JOINT UNDERSTANDING OF EXPECTED AUDIT FEES AND POTENTIAL VARIATIONS

CONCLUSION:

We conclude that the communication with clients in relation to expected audit fees and potential variations is effective.

Findings

The Client Service Plan (CSP) is the primary means for officially communicating Audit Fees and changes in audit fees each year to clients. Audit Office practice is to present the CSP to each Agencies Audit Committee where appropriate. This helps ensure effective presentation to enable the joint understanding of fees to be obtained.

The CSP states that “the fee assessment is based on the agency’s existing circumstances and any substantial and unforeseen changes will incur an additional fee.....The Audit Office will rely on the following assumptions when estimating the budget hours:

- Compliance with all audit requirements as detailed in the client assistance schedule;
- No significant changes to the organisational structure or accounting systems;
- No major breakdowns in internal controls during the financial period; and
- Internal Audit undertakes all work detailed in the Internal Audit Plan and, if appropriate, any additional work as agreed by us.

The Audit Office will notify you immediately if it anticipates a change to the audit fee.”

In order to test this we asked specific questions in our survey to financial audit clients, with the following results:

Questions	Answer Options		Strongly Agree		Agree		Neither Agree nor Disagree		Disagree		Strongly Disagree	
	Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree	Strongly Disagree	Agree	Disagree	Strongly Disagree	Strongly Disagree		
The planning process (including Client Service Plan) clearly indicated the expected audit fee for the services provided by the Audit Office and the reason for changes	15%	15	77%	75	6%	6	2%	2	0%	0		
Where fee variations arose my organisation was adequately informed of the reasons why	10%	10	48%	47	17%	16	3%	3	2%	2		

NB: 19% of respondents noted that fee variations were not applicable. Although it should be noted that the percentage of Financial Audit clients that have no fee variations, in any one year, is much higher.

The additional comments received highlighted some concerns for a small number of agencies around communication of fees, billings and fee variation year on year. However the issues raised appear to align with our findings in relation to small agencies around value for money at Section 6.2 A.

No recommendations have been raised in relation to these findings.

B. THE SCOPE OF THE PERFORMANCE AND COMPLIANCE PROGRAMMES AND OF INDIVIDUAL AUDITS WITHIN THESE PROGRAMMES

CONCLUSION:

The Auditor General communicates effectively with client Agencies in regard to the scope of the Performance Audit Program and in regard to individual Performance Audits.

Since no Compliance Audits were undertaken in 2007 and 2008 the review did not consider communication in relation to the scope of the compliance programmes. However, through discussion with Audit Office management we are satisfied that planned communication in relation to the 2009 Compliance Audit program will be appropriate.

Findings

The Performance Audit program is derived from a rigorous process undertaken by the Audit Office to ensure appropriate representation across industry sectors and to ensure appropriate alignment with a whole of government issues. The Audit Office refers to this process as developing the Strategic Audit Plan (SAP) and it provides a tool to effectively manage forward planning on a rolling three year cycle.

As detailed under Section 6.3 above a variety of sources are considered to arrive at an appropriate schedule of audits that are published in the SAP. The Audit Office is cognisant of industry coverage and whole of government risk but also considers a practical approach to inform the public of issues that are topical and within the public domain. The Audit Office formalises the process by contacting the relevant CEO of the Agency subject to scrutiny to determine if there is any impediment to the audit proceeding. Following this process, the list of planned audits is posted on the Audit Office website.

Each Agency contact surveyed for our Performance Audit review confirmed:

- The selection of topics for review appears to be based on a robust methodology (72% either agreed or strongly agreed, with one respondent disagreeing and the remainder neither agreeing or disagreeing)
- The methodology appears to consider a whole-of-government risk management perspective and central agency priorities (percentages as above)
- The Agency was provided adequate opportunity to comment on the proposed scope/terms of reference for the Performance Audit (100% of respondents agreed); and
- The final scope/terms of reference for the Performance Audit reflected relevant risks and issues to the Agency within the context of the performance topic under examination (93% of respondents agreed).

At the commencement of each audit, there is a formal exchange of letters with the Agency subject to scrutiny. This was evidenced in each audit file subject to testing for this audit. The Agency is provided with a copy of the draft audit plan and proposed lines of inquiry are provided for Agency comment. The audit does not commence until the lines of inquiry have been endorsed by the Agency. This enables the Audit Office to confirm the audit objective and associated criteria taking into account any feedback and suggestions for changes in scope from the Agency. The scope of the audit is included in the Appendix of the final published report. Our audit indicated that the scope generally did not change during the course of the audit.

As noted above in relation to recommendation #13 some instances were identified where the lines of inquiry provided in the final report varied slightly from the lines of inquiry in the planning documentation. In one instance the variation suggested to the reader that the audit may have represented a change in scope.

Review of other jurisdictions

As noted above the Audit Office provides an effective level of communication with clients in relation to its Performance Audit program and of individual audits within that program. However we note that this is primarily limited to a one year view on current proposed activity.

In our review of other jurisdictions we noted an important initiative that has been adopted by the Victorian Auditor Generals Office through the publication of their annual plan, which we believe provides for improved accountability. The contents of the plan provide a review over the last three years of performance audit activity and expected audit activity over the next three years. Whilst tabling of the Plan is a legislative requirement in Victoria the Auditor-General reserves the discretion to replace or reshape topics to accommodate issues of higher risk that may emerge.

<i>Issue:</i>	There is currently only limited disclosure with regards to the scope of the performance and compliance audit programs. Publishing a plan ensuring effective notice is provided across all stakeholder groups and may have the added benefit of improving accountability without the need to undertake all audits.
Recommendation #20:	The Audit Office should consider publishing a rolling three year plan of performance and compliance audits similar to that published by the Victorian Auditor-General's Office. This can consider both past and potential future proposed audits and provide an incentive for improved accountability. It would remain subject to changing circumstances.

C. PROVISION OF ADEQUATE NOTICE OF DRAFT REPORTS TO PARLIAMENT FOR LARGER AGENCIES TO PROVIDE INFORMED COMMENT

CONCLUSION:

The Auditor General provides adequate notice of draft reports to Parliament for Agencies to provide informed comment.

Findings

In reviewing this area we considered both financial and performance audit reports through our detailed file review, client meetings and our own survey results.

Financial Audit

In relation to Financial Audits the Auditor General includes the nature of the audit opinion, commentary on performance information, abridged financial information and comment on activities for larger agencies in his reports to Parliament.

We note that there is no specific requirement under the Act for the Auditor-General to provide a period of time for Agencies to comment on their elements of the draft reports to Parliament.

The Report to Parliament is noted in the Audit Office Guarantee of Service however only from the position of the tabling within Parliament within four and a half months of receiving the client's financial report. In the permanent CSP the Audit Office notes "we will email to the person nominated by your agency (for comment) a draft of your agency's Report comment. Any response must be in electronic format. The response will be considered and the draft comment may be amended, with part or all of the response being included at the end of the Report comment." Given the nature and timing of the report in the audit cycle it could be difficult to provide an guarantee in relation to the number of days turnaround an Agency may have to comment on the draft.

Results of our Financial Audit client survey in relation to this area were as follows:

Question	Answer Options		Strongly Agree		Agree		Neither Agree nor Disagree		Disagree		Strongly Disagree	
My organisation was provided adequate opportunity to comment on draft reports to be provided to Parliament	14%	13	63%	60	11%	11	1%	1	1%	1		

NB: For 10 respondents the question was not applicable – presumably because they were not an Agency subject to a Report.

The responses on adequacy of time to comment on draft reports to be provided to Parliament suggest that client agencies are satisfied. However one comment was received from a General Government Sector Agency in with over 10,000 employees and appropriation / revenue of up to \$2 billion which stated – “The report to be tabled at Parliament was incorrect and inappropriate. Not enough time was allocated to get it reviewed and corrected.” Based on our other review procedures we believe this was an isolated incident

The above is in line with results of the Audit Offices own client survey as published in the 2007/08 annual report which stated that 90% of respondents felt they had the opportunity to comment on findings and 83% considered that the final reports to parliament were balanced, and presented the audit findings and issues accurately and fairly.

Performance Audit

It is a requirement under Section 38C(2) of the Act that the Auditor-General must not table a report on a Performance Audit unless, at least 28 days before making the report, the Auditor-General has given the Head of the Authority, the responsible Minister and the Treasurer, a summary of findings and proposed recommendations in relation to the Audit.

One of the recognised strengths of the Audit Office is their focus on communication with relevant Authorities in a timely manner. The Performance Audit files subjected to scrutiny contained documented evidence of liaison with all stakeholders and demonstrated a commitment to adhere to the legislative responsibilities for tabling reports. The audit files confirmed that clients had the opportunity to discuss findings from the audit, review draft reports and provide comments against the recommendations in the reports with significant lead time prior to the issue of final reports.

Clients were aware of the legislative provisions of the Act where the 28 day response time was provided as an indicator for formal comment. There was no evidence from the files reviewed that insufficient time was provided to respond to the recommendations in the report. All clients surveyed for the audit indicated they had been given sufficient time to review audit reports and provide comments within a timeframe that was acceptable to them. Each client representative surveyed confirmed:

- They were adequately informed of the progress of the audit
- They were adequately informed of issues as they arose, and
- They were provided adequate opportunity to comment on the findings and recommendations in the draft audit report.

Final audit reports are only issued after key data and factual information critical to the audit findings has been cleared with the Agency concerned.

Audit files contained sufficient and appropriate evidence to account for delays in tabling reports from the scheduled tabling dates in the planning documentation where delays in the audit process were realised.

There are no recommendations raised in relation to these findings.

6.6 Term of Reference Six – Recommendations from Previous Review

ASSESSMENT OF THE AUDIT OFFICES'S RESPONSE TO THE RECOMMENDATIONS OF THE 2006 REVIEW OF THE AUDIT OFFICE

CONCLUSION:

The Audit Office has undertaken appropriate actions to address the vast majority of the recommendations from the 2006 Review.

In it's Response to the Report of the 2006 Review the then Auditor-General stated that "we accept all the recommendations made by the reviewers and will implement them as soon as possible."⁴

Changes in circumstances have resulted in one of the recommendations no longer being applicable. In addition the nature of actions in relation to three of the recommendations means they have not been fully addressed, however we do not believe, given current circumstances and the findings of our review, that they warrant additional recommendations being raised except for Audit Office formal consideration of the close out of the 2006 recommendations and addressing ongoing issues, as noted in the recommendation below.

Findings

The findings below represent our assessment in relation to each recommendation, and sub-recommendation, raised in the 2006 PAC review. Below each recommendation, we have summarised the issue to which it related, outlined actions taken and summarised our assessment. This assessment is categorised as either – Fully Addressed, Partially Addressed, Not Addressed or No Longer Applicable. Where appropriate we have cross referenced to recommendations raised elsewhere in this report.

Prior to the commencement of this review the Audit Office engaged its Internal auditors to conduct a pre PAC Triennium Review which included an assessment of the progress made towards implementing the recommendations identified during the 2006 PAC review and the outstanding recommendations relating to the 2003 PAC Review. We used the findings of this Internal Audit report together with the findings of our own fieldwork to make our assessment.

<i>Issue:</i>	<p>Our analysis of the status of previous recommendations revealed that whilst most have been fully addressed, some items in relation to three areas have only been partially addressed.</p> <p>In addition the Internal Audit pre PAC Triennium Review undertaken prior to our assessment raised a number of recommendations which the Audit Office have agreed to action.</p>
Recommendation #21:	<p>In order to formally close out the 2006 Recommendations the Audit Office should assess whether any further action is required in relation to partially addressed recommendations and ensure all recommendations raised in the recent Internal Audit are actioned as appropriate.</p>

⁴ Extract from letter by RJ Sendt, Auditor-General dated 20 June 2009.

6.6.1 Recommendation 1 (Financial Audit – enabling technology)

A specific selection criterion should be included in the current review of available methodologies and audit-enabling software to ensure that the Audit Office is able to cost-effectively and efficiently update them for changes in professional or legal requirements on an ongoing basis. The ad-hoc approach to updates outside the core methodology or audit-enabling software may increase the risk of non-adoption or compliance of Professional Standards or Legislation.

Summary Issue 2006

Due to the cost of ad-hoc changes to the Financial Audit methodology and audit-enabling technology (required to be made by an external provider) any changes in Professional Auditing Standards are not embedded into software but are instead addressed independently through the creation of Word documents which outline new instructions.

Current Situation

Deloitte has agreed to provide the Audit Office with updated versions of the software and audit packs as and when they are released. This new agreement runs until December 2010. Due to the need to tailor the software to suit the Public Sector, the Audit Office in the past, was unable to take advantage of regular updates. The re-write of the Auditing Standards has allowed this tailoring to be discarded and a glossary of terms is now used. The Audit Office is therefore able to accept the new versions of the software as and when they are available. In addition Audit Support undertakes a due diligence of AS2 revisions and monitors compliance of with all Auditing standard requirements

Assessment of response

The original finding has now been addressed by the implementation of the new agreement with Deloitte. Any changes to Professional Auditing Standards will be embedded into new releases of the software. However we note this issue will have to be again considered as part of **Recommendation #1**.

Status: Fully Addressed

6.6.2 Recommendation 2 (Financial Audit – Other financial information)

The New South Wales Audit Office should communicate the requirements under AUS 212⁵ 'Other Information in Documents Containing Audited Financial Reports' to all staff.

The standard management representation letter issued at the completion of the audit and often before the drafting of the Annual Report should be updated. The standard letter currently details the responsibility of the Client Agency in respect of the electronic publication of the financial report (subsequent to Audit Office "sign-off" of the financial report). The letter should also detail the requirement for the Annual Report (in final proof) to be provided to the Audit Office for review.

A formal approval process should be adopted and a formal letter of clearance issued by the Audit Office. The management representation letter should state that the Annual Report will not be printed or otherwise published until the formal letter of clearance is provided.

⁵ (Note AUS 212 issued Oct 1995 superseded by ASA 720 issued April 2006), requirements unchanged.

The Client Service Plan (CSP) should also specifically address the requirement of AUS 212⁶ 'Other Information in Documents Containing Audited Financial Reports'.

Summary Issue 2006

Three of nine Financial Audit files tested in 2006 did not document review of other financial information. In addition three of eleven client agencies indicated they either did not provide their annual report to the Audit Office prior to publication or if they did they were not provided with feedback.

Current Situation

A biannual e-mail reminder outlining the requirements of ASA 720⁷ is sent to all Financial Audit Branch staff.

The Management representation letters have not been amended to state that the Annual Report (final) is to be provided to the Audit Office for formal clearance prior to being printed or published nor has a formal clearance letter process been adopted.

There is a section in the Permanent Client Service Plan which outlines the requirement for a copy of the final draft of the annual report to be issued to the Audit Office prior to the issue of the Independent Auditor's report and opinion.

Assessment of response

The recommendations were only partially been implemented, since the representation letter was not amended. However we believe the change in the CSP provides appropriate notification. In addition whilst a formal clearance letter would provide added comfort, it does not address the core issue of trying to ensure documents are provided to the Audit Office in the first place. Hence we have not raised any further recommendation or need for follow up in relation to this recommendation.

Status: Partially Addressed

6.6.3 Recommendation 3 (Performance Audit – methodology)

The NSW Audit Office gives consideration to:

- I. The use of consistent terminology for scope and criteria elements in Audit Plans.
- II. Ensuring that scope items included in Audit plans are appropriately reflected in Final Reports.
- III. Reviewing detailed actual costs of Performance Audits with detailed budget costs.
- IV. Use TOPS more effectively. Update the system for budgeted / achieved milestones.
- V. Specify elements in and regularly update Risk Management Plans.
- VI. Use more specific terminology in Communications Plans.
- VII. The Source of all documents should be documented in detail.
- VIII. Streamlining further Performance Audit reports.
- IX. Refine the use of performance scorecards.
- X. Evaluate the performance and review the use of consultants.
- XI. Ensure working paper files are complete and accurate.

⁶ (Note AUS 212 issued Oct 1995 superseded by ASA 720 issued April 2006), requirements unchanged

⁷ See footnote 2

Summary Issue 2006

The above recommendations were based on a range of issues identified during the 2006 review through the testing of a sample of Performance Audits found:

- I. Most Performance Audit plans tested referred to scope and criteria, one however used the terms hypotheses and sub hypotheses.
- II. One Performance Audit report had completely different objectives and criteria to that of the original Audit Plan and there was no evidence that changes had been agreed with the client.
- III. Testing identified that actual costs of Performance Audits were compared with the overall budgeted costs rather than with the detailed budget. This made it difficult to see whether the work was in line with original expectations.
- IV. Milestones used for monitoring purposes within TOPS were not entered.
- V. Risk Management Plans required for each Audit plan were noted as being generic rather than specific and there was no evidence on file of any of the risk plans being reviewed during the audit.
- VI. Communication strategies required for each Performance Audit were noted to be generic rather than specific. There was no evidence that communication strategy had been reviewed during the Performance audit.
- VII. Review of Performance Audit documentation revealed that it was often not clear whether the documents were obtained from general research or specific individuals, whether documents were draft or final versions and what the original purpose of the document was.
- VIII. The formatting of recommendations differs between reports with some clearly highlighted and others less so. Some reports use an "Improved Practice" tick.
- IX. Performance Scorecards included in the Performance Audit completion checklist are not always completed in detail or with comments for improvement. It was unclear how these scorecards fed through to performance management.
- X. Testing identified that the process for selecting experts for use on audits was not always formally documented. This made it difficult to see the basis for selection. Experts were typically engaged after the audit had progressed to the issues discussion stage with the client and the drafting of the final report.
- XI. Audit files showed different levels of maintenance. Some were heavily indexed and cross referenced whilst others were not. It was difficult to determine if all emails, minutes of team meetings, and correspondence had been documented. There was inconsistency in the storage of documentation in hardcopy and electronic form.

Current Situation

Subsequent to the 2006 review there appears to have been a significant strengthening in the guidance provided to performance auditors through new and updated practice notes and checklists. These practice notes cover a range of the issues and recommendations raised above.

The TOPS system was replaced by eTrack in May 2007. The eTrack system is used to monitor and manage budgets and timeframes. eTrack includes scheduling, project tracking and costing capabilities. Once the audit plan is approved milestones are entered into the project tracking function for project management purposes.

Assessment of response

Based on the above we have assessed that this recommendation has been fully implemented. However we note that as a result of our review we have raised a number of **Recommendations #7-13** aimed at further enhancing the framework and its application.

Status: Fully Addressed

6.6.4 Recommendation 4 (Financial Audit – reliance on Internal Audit)

The 'Reliance on Internal Audit' section of the CSP should be re-worded to require a more positive statement in respect of reliance on Internal Audit. Where Internal Audit work is not to be relied upon, the NSW Audit Office should provide reasons.

Summary Issue 2006

There was a lack of clarity and consistency surrounding the level of detail in the CSP regarding the amount of reliance placed on Internal Audit. Of the Client agencies interviewed some indicated that they were not aware if the Audit Office relied on the work of Internal Audit and if it did, often failed to identify whether there could be any efficiency gains in the External Audit process through a reliance on Internal Audit. Several of the preliminary risk assessment working papers reviewed showed no evidence of consideration of Internal Audit.

Current Situation

Section 8 of the Annual CSP addresses reliance on Internal Audit and covers both consideration and analysis of the work of Internal Audit. Financial Audit files sampled during our review, included assessments on the reliance to be placed on Internal Audit work. However, in general this was limited, with on occasion reference to specific reviews. Reasons for non reliance were not generally clearly documented.

Assessment of response

In relation to documentation in the CSP the recommendation appears to only have been partially addressed and ongoing diligence is required in relation to documentation of the assessments of the extent of reliance or non-reliance.

However given the requirements of the new Auditing Standards, and the methodology used by the Audit Office, it is less likely that reliance on Internal Audit would be placed. Rather Internal Audit activity and reports are used to inform the auditors during the planning process in relation to the audit approach. Given this we have not raised a separate recommendation.

Status: Partially Addressed

6.6.5 Recommendation 5 (Performance Audit)

Performance Audit Branch continues with, and seeks improvements in the following initiatives:

- I. Independent surveys of parliamentarians and clients;
- II. Peer reviews;
- III. Benchmarking with other audit offices; and
- IV. Performance measures.

Summary Issues 2006

The NSW Audit Office has implemented appropriate methodologies to improve the levels of efficiency in their operations. Parliamentary survey results indicated a significant improvement in the ease of understanding of Performance Audits and quality aspects tested. Peer reviews by members of the New Zealand and Western Australian Audit offices were conducted.

The Performance Audit Branch has adopted and refined various performance measures which are included in the Annual Business Plan. Further refinement of performance measures each year should see further improvements in the efficiency of the Performance Audit Branch.

Current Situation

As noted elsewhere in this report the Performance Audit Branch (PAB) has put in place a range of activities to ensure ongoing continuous improvement including ongoing client and parliamentary surveys and the recent completion of a peer review by members of the Western Australian and New Zealand Audit Offices. Members of the PAB have also taken part in peer reviews in other jurisdictions. In addition through ACAG the Audit Office takes part in an annual benchmarking survey.

Performance areas within PAB are set annually and reporting on which cover Strategic, Operational and Reporting and are split into a range of categories including Parliament, audit clients, People, Benchmark, Business fundamentals and Financial.

Assessment of response

Performance Audit Branch has sought to address each part of this recommendation. This recommendation has been fully implemented.

Status: Fully Addressed

6.6.6 Recommendation 6 (Performance Audit Planning)

The Audit Office gives consideration to;

- I. Reconciling the issues listed in the Strategic Audit Plan and the topics listed in the Annual Audit Plan with the Total State Sector Environment Analysis and watching briefs;
- II. Indicating within watching briefs and risk assessments which issues have been or are being audited and which are planned to be audited;
- III. Reviewing and documenting the methodology for arriving at the percentage of audits to be conducted across the various performance sector areas;
- IV. Ensuring appropriate follow up of suggested audit topics from Members of Parliament and Agency Heads including provision of advice as to what action has been taken on their suggestions. The level of response from Members of Parliament and Agency heads should be monitored annually.
- V. A database of suggested audit topics be implemented for the purpose of monitoring and discerning trends over time.

Summary Issues 2006

The 2006 analysis of the Strategic Planning process disclosed:

- I. The whole of government risk assessment (Total State Sector Environment Analysis) is undertaken by the FAB, with input from the PAB watching briefs. Although the assessment was used in the overall strategic planning process there was no clear linkage between it and the issues listed in the strategic Audit Plan
- II. There appeared to be little feedback from the audit planning process back into the watching brief or risk assessment. They were not always updated for audits underway.
- III. No reasoning was documented on the strategic planning files as to how the number of audits to be conducted in each performance area was determined
- IV. There was no documentation of any feedback being given to those members of Parliament and Client agency Heads who made suggestions, as to whether audits would be conducted in the areas they had identified
- V. There was no database of suggested topics

Current Situation

Given the detail of the above recommendations and alignment in relation to our own review findings we have provided an analysis in relation to each sub component as follows:

- I. The new Whole of Office Strategic Audit Plan approach obtains input from eight Strategic Issues Groups (SIG's) who are responsible for reporting on the top five performance issues for their area.
- II. In March 2006 Practice Note 2 was issued which details the process for the preparation of watching briefs. These feed into the Strategic Audit planning process. Practice Note 2 does not require the disclosure within the brief of those issues which have, are or will be audited. A Master list of issues showing the issue, source, and audit status is sent to the SIG's for discussion at the annual Strategic Audit Planning Workshop. Practice Note 1 which was updated in Feb 2009 to reflect this process. An annual presentation outlining the issues identified by the SIG's is part of the Strategic Audit Planning process.
- III. For the period 2008 – 2011 each SIG was allocated a weighting which determined the number of Performance Audits to be carried out in each area. These weightings were calculated based on the level of stakeholder interest reflected in the 2006 State Plan.
- IV. The Auditor-General sends correspondence to Parliamentarians and selected Agency heads in November requesting suggested performance audit topics. Responses are recorded in a spreadsheet. All suggestions received are monitored annually through the Master spreadsheet which is sent to all interested parties (watching brief participants and members of SIG's). This process does not provide feedback to Parliamentarians or Agency heads whose suggestions have not been selected as Audit topics.
- V. The Master Issues spreadsheet includes all potential stakeholder inputs.

Assessment of response

Changes in the Strategic Audit Planning process as outlined above and in Section 6.3 have substantially addressed the recommendations made.

The one area that had not been addressed is a minor one in relation to feedback being provided to Parliamentarians or Agency heads whose suggestions have not been selected as Audit topics. Recommendations made by the Audit Offices Internal Auditors to clarify the communication protocol in this regard have been agreed, with a follow up protocol in relation to suggestions to be adopted.

Status: Fully Addressed

6.6.7 Recommendation 7 (Planning)

The NSW Audit Office Audit Manual and Programme for each financial year should clearly document the linkages between the Total State Sector Environment Analysis and the Compliance Audit Topics selected where these linkages exist. Evidence of the linkage of individual risks by Agency against the Compliance Audit topics selected should also be documented.

Summary issue

The Financial Audit Executive utilises the Total State Sector Environment Analysis to determine the Compliance Audits that should be conducted in each agency. Clear linkages between the Total State Sector Environment Analysis and the Compliance Audit topics selected in 2004-05 were difficult to identify.

Current Situation

As noted above there have been no Compliance audits carried out since 2006, due primarily to the diversion of resources to deal with the increased requirements of the new Auditing Standards. As noted in 6.1.3 above a new compliance audit framework designed in reference to ASAE 3100 has been developed by the NSW Audit Office. In addition the Compliance audit topics chosen for the 2009 program arose from the new whole of office SAP progress which utilises input from the SIGs.

Assessment of response

Due to the method used in selecting Compliance Audit topics this recommendation is no longer applicable.

In addition as noted under 6.3 B above we believe the selection of an Agency for inclusion, in a compliance audit program, should be based on it being a risk for that Agency rather than the overall risk profile for the Agency.

Status: Not applicable

6.6.8 Recommendation 8 (Performance Audits and Staffing)

- I. That the NSW Audit Office consider means of communicating the level of skills and experience of audit staff to clients so that they can be assured that the audit team has the appropriate skills;
- II. That the engagement of experts be communicated to clients; and
- III. That the selection process and performance evaluation of experts be documented.

Summary Issue 2006

The 2006 report noted that clients highlighted they were not aware that the Performance Audit team had utilised experts on their audit and that the selection and evaluation processes for experts were not clearly documented.

Current Situation

The Performance Audit Branch has changed the information included in the Audit Plan which is issued to the client and the appendix to the report that outlines the audit approach. The Audit Plan and appendix details the names of the audit team and how they developed their expertise in the topic under review. Audit Teams are encouraged to use consultants to provide specialist assistance.

Clients are now advised as soon as a consultant is engaged on an audit and in addition when a consultant's work is complete a post audit evaluation is carried out.

Assessment of response

The changes made by the Audit Office have fully addressed the recommendations. Although we would consider the use of CV's or similar attached to the audit plan could provide an enhanced level of communication of audit staff skills and experience.

Status: Fully addressed.

6.6.9 Recommendation 9 (Performance Audit changes)

That any changes to audit objective or scope be approved by the Assistant Auditor General, Performance Audit and the agency involved.

Summary Issue 2006

In one Performance Audit reviewed it was noted that the original objective and scope of the audit contained in the audit plan had changed during the course of the audit, and that it also differed in the appendix to the tabled Report. It was not clear whether the changes in objective and scope had been agreed with the Client during the course of the audit.

Current Situation

During the course of our detailed file review we noted a similar issue to that in 2006. Practice Note 11 states that any changes to audit objectives and scope that occurs after the audit plan has been signed off must be communicated to stakeholders. This practice note has been updated in February 2009 to require that approval from the Assistant Auditor General Performance Audit is required for any changes of objective or scope.

Assessment of response

Adoption of the February 2009 changes in Practice Note 11 will result in the recommendation being fully implemented.

Status: Fully addressed.

6.6.10 Progress regarding implementation of 2003 Outstanding PAC Review Recommendations

In addition to their new Recommendations the 2006 PAC Reviewers assessed four recommendations from the 2003 review as still to be fully implemented. For completeness we have provided an update on these below.

Financial Audit Recommendation 1 - (Low Priority)

The Audit Office should maintain their surveillance of the market in relation to changes in Audit Methodologies and automated technology solutions. Based on this surveillance, in line with standard government purchasing policy, it is recommended that on an annual basis, the Audit Office, formally document whether it is still appropriate to keep the current methodology and automated working papers or whether the market should be tested.

Current Situation

The current agreement with Deloitte for AS2 is valid until 31 December 2010. As noted in relation to our **Recommendation #1** a project should be initiated to review the market for appropriate audit enabling software, hence no additional recommendation has been raised.

Status: Partially Addressed

Financial Audit Recommendation 3 (High Priority)

The Audit Office should reinforce to its staff the requirement to assess whether a client's Internal Audit function can be relied upon during the Financial Audit process. This should include a requirement that all audit files contain documentation setting out how any Agency's Internal Audit function has been assessed and the conclusions drawn by the Audit Team. The Audit office should also ensure that Agencies are fully aware through the Client Service Plan and through entrance meetings for all Financial Audits how its Internal Audit function will be used and what impact this has had on audit fees.

Current Situation

A recommendation in relation to communicating reliance on Internal Audit was raised in the 2006 PAC Review report and this has been assessed under 6.6.4 above. A standard form within the AS2 file structure planning section is used to assess the impact of Internal Audit's work. However as we have noted elsewhere given the requirements of the new Auditing Standards, and the methodology used by the Audit

Office, it is less likely that reliance on Internal Audit would be place. Rather Internal Audit activity and reports are used to inform the auditors during the planning process in relation to the audit approach.

Status: Fully Addressed

Costs & Charges Recommendation 57 (High Priority)

Under Consultation with the PAC, the Auditor-General should prepare a funding paper to be presented to the Department of Treasury seeking full funding for the costs of the Compliance and Performance Audit programs.

Current Situation

The Performance Audit Program is fully funded. The NSW Audit Office is in discussion with Treasury in respect of the funding for the Compliance Audit Program.

Status: Fully Addressed

Reporting to Parliament – Efficiency Recommendation 78(Medium Priority)

Subsequent to legislative backing, the Auditor-General facilitate establishment of a high level Committee with the Department of Treasury and the Premiers Department that has the aim of establishing a clear and concise framework for the use of key performance indicators and benchmarking data within Department and Agency Annual Reports. As a result of this process the Auditor-General should undertake high level workshops with Departments and Agencies to assist them in understanding how to set effective quantitative and qualitative performance indicators and how to undertake appropriate benchmarking of their activities. Once this framework has been established the Auditor-General should provide comment and opinion on the key performance indicators and benchmarking data within Department and Agency Annual Reports in his Annual Report to Parliament.

Current Situation

The State Plan: A New Direction for NSW was released by the NSW Government in November 2006. It sets out priorities for Government action for the next 10 years and includes thirty four priorities and sixty targets designed to deliver better services and improve accountability across the public sector. The Auditor-General is required to verify information including KPI's detailed in the State Plan Annual Report. The 2008 Annual Report of the State Plan included a section "Information verified by the Auditor-General" within each KPI reported.

The development of the State Plan and the Auditor General's involvement in verifying information in the Annual Report of the State Plan addresses the issue raised. The recommendation is considered no longer applicable.

Status: No Longer Applicable

7 Appendix – Detailed Approach

7.1 Auditing Function

Compliance with current professional standards and legal requirements in undertaking auditing of all types;

7.1.1 Financial Audit

Financial Audit accounts for over 80% of activity within the Audit Office and as such this was our major area of review in relation to compliance. In addition Financial Audit is undertaken in a highly regulated environment with auditors subject to an array of Accounting and Auditing Standard requirements not to mention legislative requirements including requirements of both the Act and Corporations Law. There was a significant change over the period subject to review with the introduction of a new set of Auditing Standards.

Due to the size and complexity of this area we developed a number of Indicative Objectives in support of the primarily objective noted in the terms of reference. Our approach to these is detailed below:

Indicative Objective 1 - whether the Audit Office has adequate and appropriate methodology, practices and procedures

- Reviewed the audit process adopted by the Audit Office and compared it to current better practice models to ensure it is aligned. This included analysis against other State Audit Office Methodologies and the Standards of the Institute of Chartered Accountants in Australia;
- We specifically considered the methods used to ensure effecting adoption of the new Auditing Standards during 2007; and
- In reviewing the application of the process we considered whether practices, procedures and staff training appear to provide effective mechanisms for its application.

Indicative Objective 2 - whether the audits are supported by adequate plans and work papers, appropriate audit evidence and appropriate quality control procedures

- To achieve this objective we performed a peer review over a range of audits undertaken by the Audit Office. We conducted our work based on a sample of thirteen different audit office clients which ranged in size and complexity. This included one audit conducted by an outsourced service provider and ranged across the various audit office business teams. All selected client engagements were selected for the 2008 year together with a sample of some for the 2007 year;
- Our peer review methodology was tailored to ensure additional government requirements/responsibilities required as an "Audit Office Financial Audit" are encapsulated in our review process. We also considered application of the internal Audit Office review processes and peer review;
- Based on the Audit methodology we developed a checklist/guide for the reviews to ensure our assessments were applied in a consistent manner;
- In particular we ensured changing Auditing Standards were complied with where appropriate and that the rationale behind subjective areas were adequately documented; and
- Discussion with selected Client and Audit Office staff formed an important element of this area.

Indicative Objective 3 - whether the audits are appropriately planned and co-ordinated

- Through discussion with Audit Office staff we gained an understanding of the processes applied;
- Reviewed the relative levels of time spent on planning, fieldwork and reporting and post audit debriefs in relation to actual resourcing;
- Discussion with Agencies and feedback was obtained through agency surveys; and

- An analysis of the timelines and costs involved in a sample of audits reviewed was used to provide an indication of the actual effectiveness of the process.

Indicative Objective 4 - whether the audit opinions issued by the Office comply with applicable professional standards and practices

- A sample of Audit Opinions issued by the Audit Office was reviewed and compared to professional and government standards to ensure they are in compliance; and
- All qualified audit opinions issued in 2008 were reviewed as part of the review.

7.1.2 Performance Audits

The focus and approach to this area substantially mirrored that of Financial Audits, with specific process steps across the audit cycle of planning, fieldwork and reporting developed based on ensuring alignment to professional standards and legislative requirements. Key steps in our review process included:

- Review of the NSW Audit Office Performance Audit methodology against auditing standards AUS 806 and AUS 808 for audits conducted prior to 1 January 2009 to ensure compliance with professional standards;
- Review specific legislative requirements as primarily detailed in Division 2A of the Act;
- A review of the Performance Audit methodology against the Asian Organisation of Supreme Audit Institutions (ASOSAI) Performance Auditing Guidelines and the International Organisation of Supreme Audit Institutions (INTOSAI) General Auditing standards;
- Detailed review of a sample of six performance audits conducted and reported during the period 2006-2009 to ensure alignment with internal policy and procedures and legislative requirements. In addition we reviewed the work papers for two potential audits which did not proceed to a full performance audit;
- Review of the Performance Audit methodology against auditing standards ASAE 3000, ASAE 3100 and ASAE 3500 (which apply from 1 January 2009) to ensure the NSW Audit Office Performance Audit methodology enables continued compliance with professional standards in the future;
- Benchmarking the Performance Audit methodology of the NSW Audit Office against the methodologies of the Australian National Audit Office and the Auditors-General of Victoria, Western Australia and New Zealand; and
- Analysing feedback from NSW agency representatives who were contacted directly on the basis that they were subject to a Performance Audit in the review period.

7.1.3 Compliance Audits

During 2007 and 2008 the Audit Office did not undertake a separate Compliance audit program due primarily to the diversion of resources to deal with the increased requirements of the new Auditing Standards.

However, a limited compliance audit program was developed during the review process for application as part of the 2009 audit cycle.

Our review focused on the development of this audit program, including work plans and agency selection and ensuring alignment to the relevant auditing standards, being ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information and ASAE 3100 Compliance Engagements.

7.2 Costs & Charges

Our approach to the two objectives outlined in your terms of reference is detailed below and for both objectives we considered processes for:

- Reporting on value for money including audit budget management;
- Any measure or mechanisms established to measure 'value for money' between the Audit Office, client agencies, the Committee or other stakeholders; and
- Client feedback including follow-up, communication and issues and dispute resolution especially around costs and charges.

a) Whether the Audit Office is providing value for money Financial Audit services in comparison with the services and fees of similar organisations

Our considerations in relation to this objective included:

- Reviewing the Audit Office's process for setting price for Financial Audit services and understanding any key assumptions including any differences across sectors;
- Understanding the differing reporting requirements of the public and private sector and the impact upon price basis, together with the effect of changes in requirements such as the new Auditing Standards;
- Reviewing the Audit Office's outsourcing process and benchmarking of costs with its internal charge process; and
- Reviewing published financial statements, identify and comparison of audit fees of comparable public sector agencies both within NSW and other States.

b) Whether Performance Audits provide value for money by meeting their objectives and contributing to improved accountability by agencies within New South Wales.

Our consideration in relation to this objective included:

- Ascertaining appropriate benchmarks for 'value for money' in regard to Performance Audits, through review of reporting, the practices adopted by other jurisdictions and concepts adopted by the Audit Office;
- Determining objectives of Performance Audits, especially around improving accountability, and measures used to assess achievement;
- Survey of select client agency representatives to assess their perceptions of value for money and review of client survey results undertaken on behalf of the Audit Office; and
- Desktop review of performance reports to assess management response to the recommendations made and quantify where performance improvements have been or are likely to be made. This included a review of the follow up audit process which is coordinated by the PAC.

7.3 Planning

a) Whether the process of selecting topics for Performance and Compliance Audits is based on robust methodology including a consideration of whole of government risk management and central agency priorities

Our consideration of this objective included an examination of the strategic and annual planning processes for Performance & Compliance Audit topics selection including consideration of:

- The degree to which incorporation of whole of government risk management and central government prioritisation was considered;
- The degree and nature of consultation with key stakeholders in the development of the topic selection criteria;
- The extent to which the application of the criteria impact on the balance of Performance Audit coverage across public sector entities and programs;

- The flexibility of the planning approach to react to changed circumstances and maintain relevance in audit topics;
- The degree to which the criteria utilised in initial topic selection are validated as part of the detailed planning of each audit;
- The use of the criteria on completion of the audit to evaluate the Audit Office's performance;
- The extent to which criteria used to select audit topics are disclosed publicly; and
- A comparison to the processes used by other jurisdictions.

b) Whether the selection of topics and agencies for inclusion in the compliance audit program is robust and based on a consideration of the particular risks of that agency.

As noted under 7.1.3 above there was no compliance audit program undertaken during 2007 and 2008. However a compliance audit plan and program for 2009 was developed during our review. This included the selection of agencies to be included in the program.

We reviewed the process adopted to assess whether it met the object noted above and compared the approach taken with other jurisdictions where appropriate.

7.4 Management & Resources

a) Whether the Audit Office has adequate resources to conduct its functions

In addressing this objective we reviewed performance and operations of the Audit Office in terms of past, current and future performance, budgets and funding plans and identified trends of key resources and indicators including :"

- Staff – FTE numbers, organisational mix, remuneration, retention, development and training;
- Overheads incl premises, IT software and hardware infrastructure;
- Access to specialists / experts and outsourced services; and
- Performance benchmarks as reported in the Audit Office annual report.

Where available we obtained data from similar organisations and industry benchmarks and compared and analyse results.

b) Whether appropriately skilled staff are undertaking Performance Audits.

In addressing this objective we initially ascertain the pool of Audit Office staff who are undertaking Performance Audits and then assessed them in terms of:

- Identifiable measures such as skills based assessment including qualifications, professional membership and experience in industry or the public sector;
- Performance development, staff development and competency framework;
- Results of agency survey initiated by the Audit Office and our own survey; and
- Compared to models used by other jurisdictions.

7.5 Communication with Clients

In assessing the effectiveness of communications with clients we reviewed internal documented processes and protocols as well as the performance against benchmarks set as part of the Audit Office guarantee of service and client service plans. This was backed up by our findings from surveys and discussions with selected agencies and the approaches taken in other jurisdictions. Specific approaches used in relation to the three sub-objectives are detailed below.

Effective communication with clients in particular in relation to:

a) Establishing a joint understanding of expected audit fees and potential variations

- Consideration of fee notifications and change processes.

b) The scope of the performance and compliance programmes and of individual audits within these programmes

- Notification processes to agencies in relation to performance audits and compliance audits.

c) Provision of adequate notice of draft reports to Parliament for larger agencies to provide informed comment.

- Assessment of protocols for the issue of draft reports for agency review and feedback and compliance with the assumed protocols.

7.6 Status on Recommendations of Previous Review

Assessment of the Audit Office's response to the recommendations of the 2006 Review of the Audit Office.

As part of the Audit Offices preparation for this review its Audit Committee commissioned the Internal Auditors to conduct a review of the status of recommendations from the 2006 Review which was completed during our fieldwork. The Internal Audit report assisted in assessing this objective which included:

- Review of previous recommendations in relation to current relevance and incorporation into our work where relevant particularly in respect of Financial, Compliance and Performance audit;
- Appropriateness of subsequent management actions in dealing with the recommendation and verification through our review procedures; and
- Consultation with Audit Office management on actions still outstanding and formulation of forward plans or alternative approaches as appropriate.

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