



***The Auditor General:
Ally of the People
and Parliament***

***Report
296
Joint
Committee
of Public
Accounts***

***Reform of the
Australian
Audit Office***

REPORT 296

**THE AUDITOR-GENERAL: ALLY
OF THE PEOPLE AND PARLIAMENT
REFORM OF THE AUSTRALIAN
AUDIT OFFICE**

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Inquiry Staff: Dr P Nicoll

Mrs L Brennan

DUTIES OF THE COMMITTEE

Section 8.(1) of the Public Accounts Committee Act 1951 reads as follows:

Subject to sub-section (2), the duties of the Committee are:

- (a) to examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of section 50 of the Audit Act 1901;
- (aa) to examine the financial affairs of authorities of the Commonwealth to which this Act applies and of inter-governmental bodies to which this Act applies;
- (ab) to examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- (b) to report to both House of the Parliament, with such comment as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Parliament should be directed;
- (c) to report to both Houses of the Parliament any alteration which the Committee thinks desirable in the form of the public accounts or in the method of keeping them, or in the mode of receipt, control, issue or payment of public moneys; and
- (d) to inquire into any question in connexion with the public accounts which is referred to it by either House of the Parliament, and to report to that House upon that question,

and include such other duties as are assigned to the Committee by Joint Standing Orders approved by both Houses of the Parliament.

PREFACE

This report presents the results of the Committee's inquiry into the Australian Audit Office, AAO.

The inquiry was the first comprehensive governmental or parliamentary inquiry into the Australian Audit Office since establishment of the Office at Federation in 1901. In the 88 years since then, Government and Parliament have changed dramatically, and the purpose and conduct of audits have also been transformed. The Committee examined the role of the AAO and the Auditor-General in the light of those changes.

The Auditor-General and the AAO are fundamental to maintenance of accountability of government officials and instrumentalities to Parliament and through Parliament to the people. The inquiry was given wide terms of reference in order to be able to address several aspects of accountability. Specifically, the inquiry asked whether the Australian Audit Office had kept pace with developments in public sector audit elsewhere in Australia and overseas, and whether current arrangements guaranteed the independence and resources necessary for the Australian Audit Office to fulfil its role as determined by the Audit Act 1901.

In 1979 the Audit Act was amended to permit the Auditor-General to undertake efficiency audits. Subsequently, not only was the Auditor-General requested to form an opinion on auditees' financial statements and accounts and records, but he was expected to inform Government and Parliament of how efficiently resources were applied. Efficiency audits are important in protection of the Parliament's interests.

Efficiency audits have made important contributions in the last ten years. Nevertheless, their contribution has been small because the Audit Office has had few resources to allocate to them. A consequence is that, according to the Audit Office's records, large programs with income or expenditure greater than \$10m can be expected to be subject to an efficiency audit only once every 40 years. This scenario is not consistent with a maximum effort to improve the public sector's efficiency.

The current emphasis on risk management within the public sector is a further factor increasing the Audit Office's responsibilities. The great majority of the Audit Office's resources are allocated for statutory financial and compliance auditing required by the Audit Act. Since there can be no diminution of attention to financial and compliance auditing, the only way to utilise efficiency audits as major instruments of public sector reform is to provide more resources for the Audit Office.

A number of changes, particularly in recent years, have tended to weaken public accountability. These changes include granting of certain kinds of instrumentalities the right to appoint their own auditors. Ministers have also been permitted to appoint the auditors of other kinds of instrumentalities, but within arrangements which complicate the division of responsibilities between the Auditor-General and an instrumentality's other auditor. The combined effect of these changes is to reduce the flow of financial information on government companies to ministers and to Parliament. In turn, this leads to a lessening in Parliament's ability to make sound laws, and a weakening of the accountability of Executive Government to Parliament.

Another weakness highlighted during the inquiry was that the Department of Finance was the principal advisor to Executive Government on the resources that should be allocated to the Australian Audit Office. This was so even though the Department of Finance was the Audit Office's most important auditee. The AAO appears to have been constrained in its efficiency audits of the Department of Finance because of this arrangement. The Audit Office had never conducted an efficiency audit of any aspect of that Department's operations, despite the centrality of the latter to the efficiency and effectiveness of the Commonwealth sector. Nor had efficiency audits ever been conducted of the Department of Prime Minister and Cabinet, the Treasury or Reserve Bank.

Many experienced Audit Office staff have been attracted to the private sector largely because of higher salaries. The latter have made it difficult for the Audit Office to recruit experienced staff, especially in specialist areas such as the application of computers to audits. Of note was that the Commonwealth Government spent more on Audit Office salaries in 1978-79 than in 1987-88. Salary differentials between certain categories of public and private sector auditors are now so substantial that maintenance of a strong audit capacity is at risk. The report discusses this problem and recommends establishment of the Australian Audit Office as a statutory authority, and granting to the Auditor-General the authority to determine the conditions of staff employment.

The Committee believes that the major inadequacies identified in this report are best overcome, and the Australian Audit Office strengthened, by promoting a closer relationship between the Auditor-General and Parliament. Specifically, the report recommends that the Auditor-General become an officer of the Parliament, and that an Audit Committee of Parliament be established to become Parliament's principal source of advice on the Audit Office's resources. These proposals are consistent with the direction of change for audit which has already occurred in the British Parliament. The effect of these changes would be to reduce Executive Government's influence over audit of public accounts. For these and other reasons, the Audit Act 1901 should be repealed and replaced by a new act more in keeping with modern government and audit.

The inquiry was announced before the current Auditor-General was appointed. Therefore, the problems identified here existed before he commenced his duties in Australia in June 1988.

The Committee has welcomed the interest shown in the inquiry by Parliamentarians, government officials and organisations, State Auditors-General, the Canadian Auditor-General who was invited to appear before the inquiry, professional associations and others who appeared as witnesses. In particular, the Committee found the co-operation of the Australian Audit Office and the Department of Finance most valuable.

The Committee expresses its deep appreciation to Dr Paul Nicoll of the Department of Employment, Education and Training who was the secretary and researcher for the work of the subcommittee and who prepared a draft report for consideration by the subcommittee. The Committee would like to thank the Department and the Public Service Commission for permitting Dr Nicoll's secondment to the inquiry through the Executive Development Scheme. The Committee extends its best wishes to Dr Nicoll in his future career and thanks him for his contribution to the work of the Parliament. Support was provided by Mrs Laraine Brennan.

The Committee has produced comprehensive recommendations on the vast array of issues raised in the course of the inquiry. It is the unanimous view of the diverse members of the Committee that the report is a significant step forward in the process of reform of parliamentary democracy.

For this reason the Committee urges that the report be read widely by parliamentarians, professional associations, academics, public servants and by the public. The Committee commends the report to the Government for implementation at the earliest opportunity.

For and on behalf of the Committee

R E Tickner, MP
Chairman

M J Talberg
Secretary
Joint Committee of Public Accounts
Parliament House
CANBERRA
9 March 1989

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SUMMARY

The inquiry examined the role and condition of the Australian Audit Office, AAO. Since the AAO was an 'arm' of the Auditor-General, the role of that officer was also examined.

The report argues that a strong Australian Audit Office is essential for maintenance of the accountability of Federal Government organisations and officials to Parliament. The statutory relationship between the Auditor-General and Parliament, which has not changed since Federation, needs major revision to reflect, first, the evolution of government in the 88 years since Federation, and second, evolution in the role of audit. The intention is to add meaning to Parliament's status as the Auditor-General's client. Therefore, fundamental to reform of the Audit Office is establishment of a better foundation for relations between the Audit Office and Parliament.

From that basis, the report addresses the question of what should be the limits of the Auditor-General's responsibilities, or for which Federal Government organisations should he be the external auditor.

Analysis of whether the Audit Office had sufficient resources for financial and compliance audits was inconclusive. Notwithstanding, doubt remained over the adequacy of those resources. On the other hand, resources for efficiency audits were so inadequate that, according to Audit Office records, it would take 40 years to conduct an efficiency audit of all government programs with income or expenditure greater than \$10m annually. Because of legislative and financial constraints, the Auditor-General could devote only about 10 per cent of resources to efficiency audits, while the percentage of resources devoted to similar tasks in Great Britain and Canada was approximately 50 per cent, with an even higher proportion in the United States. No reasons were given during the inquiry for why the AAO should continue to lag so far behind other national audit offices in its contribution to public sector efficiency and effectiveness. Accordingly, additional funds were recommended by the Committee.

The Audit Office's internal organisation was out of step with modern accounting practice. Large private sector accounting firms, on average, had a partner: staff ratio of approximately 1:12. The equivalent ratio in the Audit Office was approximately 1:24. The reasons for this situation were largely outside the Auditor-General's control. Salaries of senior staff were less than half those of their private sector peers. This was at a time when demand in the economy for persons with accountancy

skills was very strong. The result was that the Audit Office had major problems in recruiting staff. In the Committee's view, the overall effect of these factors tended to diminish the AAO's effectiveness and efficiency in public sector audit.

Current audit legislation was outdated. Separation of the financial management and audit provisions of the Audit Act 1901 was necessary.

For these and for other reasons, audit provisions of the Audit Act should be repealed and replaced by separate audit and financial management legislation.

Recommendations

The categories of recommendations listed below are not necessarily discrete. The Committee's analysis in the text should be referred to when considering these recommendations. Page numbers are indicated. Recommendations are numbered here but not in the text.

Legislation

1. The Audit Act 1901 be repealed, and replaced by two new laws, a Financial Administration Act and an Audit Act. (Page 240)

2. A Parliamentary committee be established to advise the Auditor-General on Parliament's audit priorities and to consider the Australian Audit Office's finances in detail. The Committee will report to Parliament. It will be titled the Audit Committee of Parliament, and have the following membership of nine persons:

President of the Senate or Speaker of the House of Representatives, alternating each year;

Minister for Finance;

Public Accounts Committee Chairperson;

the Chairperson of a House of Representatives committee which uses AAO reports;

the Chairperson of a Senate committee which uses AAO reports or which reports on changes in public administration;

three members of the Opposition;

a Parliamentarian who is a member of a minority party which is not part of the Government or Opposition. If no such person is in Parliament, then a member of the Opposition.

The Speaker and President will alternate as Chairperson on an annual basis. (Page 72)

3. Future audit legislation state unequivocally that the Auditor-General is an officer of the Parliament in order to emphasise the Auditor-General's relationship with Parliament. (Page 76)

4. The Government appoint an advisory panel comprising the Chairperson of the Audit Committee of Parliament and the Minister for Finance, and one person nominated by the Leader of the Opposition. Further, nominations to fill future vacancies of the post of Auditor-General be made by the Prime Minister after consultation with the advisory panel. The Governor-General will make the appointment. (Page 77)

5. Auditors-General be appointed by the Governor-General in Council and shall not be removed except by the Governor-General in Council, on an address from both Houses of the Parliament in the same session, praying for such removal on the ground of proved misbehaviour or incapacity. (Page 81)

6. Future appointments to the post of Auditor-General be for ten years or until the incumbent reaches the age of sixty-five years, whichever is sooner. (Page 79)

7. Legislation be introduced to establish the Australian Audit Office as a statutory authority, and to permit the Auditor-General to determine the terms and conditions of employment of Australian Audit Office staff. (Page 84)

8. The Audit Act 1901 be rewritten to clarify the role of the Auditor-General and his Office. (Page 236)

9. The Australian Audit Office be renamed the Australian National Audit Office. (Page 237)

10. Section 70BA of the Audit Act 1901 be amended to permit the Auditor-General to delegate to qualified staff the authority to sign audit reports on Government companies. (Page 85)

11. New Commonwealth audit legislation maintain the Auditor-General's authority to:

undertake large and small performance audits;

access Commonwealth departments and other agencies;

report the results of performance audits.
(Page 140)

12. Audit legislation state that the Auditor-General must report whether satisfactory procedures have been established to measure and report on the effectiveness of programs. (Page 157)

Resources

13. In keeping with the user pays principle, in future Parliament pay all audit fees. The practice of auditees being charged audit fees should cease. (Page 66)

14. In future, the Australian Audit Office calculate the average costs of all audits, and that calculations should be based on the formula used to estimate audit fees. (Page 49)

15. The Australian Audit Office's appropriations be included in the Appropriation (Parliamentary Departments) Bill. (Page 71)

16. The funding of efficiency audits be based on the following four principles, which would be the basis of a funding formula to be adopted by the Audit Committee of Parliament:

a legislative requirement for efficiency audits;

separate determination of the budget for regularity and performance, specifically efficiency, audits;

linkage of funds for efficiency audits with growth in government income and outlays, and with change in the structure of government programs; and

the Australian Audit Office's performance in regard to efficiency audits. (Page 227)

17. The Australian Audit Office adopt the following cycle of audits for all programs with expenditure or revenue greater than \$10m:

a 20 year cycle for government companies;

- a 10 year cycle for statutory authorities;
- a 5 year cycle for departmental commercial undertakings;
- a 5 year cycle for departmental outriders; and
- a 3 year cycle for departments. (Page 231)

18. There be major recruitment of senior staff from either within or outside the public sector. (Page 211)

Mandate

19. The Auditor-General should be reinstated as the external auditor of Statutory Marketing Authorities, considering their strategic importance in the Australian economy. (Page 92)

20. Where the services of a private audit firm are considered necessary by a Statutory Marketing Authority and the Auditor-General agrees, then the Auditor-General should appoint a private audit firm as contract auditor under section 11 of the Audit Act 1901. (Page 92)

21. The Auditor-General be reinstated as the external auditor of Government Business Enterprises. (Page 107)

22. Amendments be made to legislation governing AUSSAT, QANTAS and Australian National Railways Commission, and to the Audit Act 1901 to restore the Auditor-General as their external auditor. (Page 107)

23. The Audit Act 1901 be amended to require the Auditor-General to be appointed the external auditor of all Government companies. Private sector audit firms and partnerships which are the external auditors of government companies would continue until their appointments expire whereupon the Auditor-General would become the company's external auditor. The Auditor-General, after consultation with the appropriate minister, may decide to contract a private sector auditor to undertake the audit on the Auditor-General's behalf. (Page 108)

24. The subsidiaries of all statutory authorities government owned companies and Government Business Enterprises should be audited by the Auditor-General. (Page 109)

25. The Auditor-General should not develop other specialties permitting the Audit Office to operate as a consultant in fields such as:

human resource management,
financial management,
taxation,
investment advice, or
computer systems,

except where areas are developed as a result of evolution of the audit task. (Page 117)

Performance Audits

26. The Auditor-General continue to have responsibility for efficiency audits. (Page 131)

27. The general principle that efficiency audits be conducted by multi-disciplinary teams be accepted. Further, in conducting efficiency audits, the Auditor-General ensure that a sufficient level of experience and expertise relevant to the audit subject is available to the efficiency audit team. (Page 153)

28. The Auditor-General give priority to development of the capacity to criticise constructively auditees' evaluation plans without commenting on the merits or otherwise of government policies and recruit staff with the skills necessary to analyse evaluation plans and practices. (Page 157)

29. The Auditor-General initiate each year a number of efficiency audits spanning more than one program or agency. This focus could coincide with experimentation in audit reports, for example, through release of discussion papers on audit topics. (Page 159)

30. The Auditor-General and the Secretary of the Department of Finance consult on topics for efficiency audits. Further, the Auditor-General also consult with Parliamentary committees on topics for efficiency audits. (Page 160)

31. The Auditor-General be required to provide a final efficiency audit report within six months of initiation of selected efficiency audits. Further, that this requirement be introduced on an experimental basis for a two year period to determine the effects on resources, selection of topics, and accountability to Parliament. (Page 146)

32. The Auditor-General trial for two years the conduct of efficiency audits of commercially oriented government organisations with restricted reporting as provided for under section 48F of the Audit Act 1901. Further, restricted reports be provided to the Minister responsible for the auditee organisation and to the Public Accounts Committee. (Page 177)

33. For selected efficiency audits, the Auditor-General consult with the departmental secretary or chief executive officer of the instrumentality to be audited to permit temporary appointment of an auditee staff member or members to the efficiency audit team. (Page 146)

34. The Auditor-General publish in his annual report details of all or any instances of a minister refusing the Auditor-General's request to conduct an efficiency audit of government instrumentalities where such permission is required. (Page 169)

35. Section 48C of the Audit Act 1901 be amended to permit the Auditor-General to conduct an efficiency audit of an eligible incorporated company without a minister's permission. Further, the definition of eligible incorporated company be amended to give effect to the Committee's concerns that the current definition excludes a company which is incorporated as an initiative of the Commonwealth and which receives the majority of its funding from the Commonwealth but which for policy reasons has a board of directors on which Commonwealth representatives are in a minority. (Page 170)

36. A detailed review of efficiency audit guidelines for Government Business Enterprises be undertaken, as recommended in the Committee's Report on the Australian Wool Corporation's property operations (Report 282). Further, this review should be undertaken by the Auditor-General and include new guidelines for Statutory Authorities, Statutory Marketing Authorities and government companies, involving representatives of those organisations and the Department of Finance. (Page 183)

37. In accordance with the recommendation of the House of Representatives Standing Committee on Transport, Communications and Infrastructure, where an auditee accepts the proposals for change made by the Auditor-General in an efficiency audit report, the auditee provide the relevant Parliamentary committee with a timetable for implementation at the commencement of the Parliamentary inquiry. (Page 189)

38. The Auditor-General devote significant resources to follow-up of performance audits, and adopt a systematic approach to follow-up of performance audit findings. (Page 198)

39. Follow-up procedures for performance audits be linked to follow-up procedures for regularity audits in the Audit Office. (Page 198)

40. In accordance with the recommendation by the former House of Representatives Standing Committee on Expenditure in 1986, the Australian Audit Office advise the Parliament of deficiencies in the consideration and implementation of efficiency audit recommendations. (Page 199)

Department of Finance

41. The Secretary of the Department of Finance ensure that Supply Divisions upgrade their effective oversight and analysis of ministers' quarterly reports. (Page 196)

42. The Department of Finance should provide to the Public Accounts Committee on a quarterly basis copies of ministers' responses received by the Minister for Finance and make those responses publicly available. (Page 196)

43. In specific cases where there are policy reasons why the reports cannot be made publicly available, then they be supplied to the Public Accounts Committee on a confidential basis. (Page 196)

44. The Department of Finance develop a stronger interest in the adequacy of internal audit in Budget-funded agencies through, for example, sponsorship of inservice education including seminars. (Page 207)

Audit of Section 96 Grants to State and Territory Governments

45. The Commonwealth Government provide additional resources to State Auditors-General where, as a result of inter-governmental agreements, they have responsibility for providing to the Commonwealth Government audit certificates on section 96 grants. These additional resources should originate from the section 96 grant and should be determined by negotiations between the granting Commonwealth agency and the State Auditor-General. (Page 125)

46. The Department of Finance and the Commonwealth Auditor-General co-operate to ensure that Commonwealth agencies give more attention to audit requirements at the program design stage. (Page 125)

47. Draft legislation on specific purpose section 96 grants be provided to the Department of Finance and the Commonwealth Auditor-General for scrutiny. (Page 125-6)

48. The granting Commonwealth agency consider whether, in the case of Commonwealth grants to State government agencies, a State Auditor-General audit certificate on the financial statement of the State recipient agency would suffice. (Page 126)

49. The Commonwealth Auditor-General explore with State Auditors-General the advantages of joint audits. (Page 126)

50. Where a State or Territory Auditor-General is required to provide an audit certificate to a Federal agency, there be a requirement in the related Federal-State agreement to provide the audit certificate by a specified date or within a specified period. (Page 126)

51. Commonwealth grants be made to State government Treasuries rather than directly to State government agencies to provide State governments with a better indication of their agencies' sources of funding and a firmer basis for intergovernmental co-operation. (Page 126)

52. The Commonwealth and State Auditors-General improve the flow of information about problems in audit of section 96 grants to provide early warning of problems. (Page 126)

Reports/Reporting

53. A requirement necessitating the inclusion of information on reports of the Auditor-General or of Parliamentary committees relevant to the agency similar to that for departmental annual reports be introduced into guidelines for preparation of annual reports by statutory authorities. (Page 191)

54. The Auditor-General list project audits in his annual report to Parliament. (Page 138)

55. Consistent with ministerial responsibility, audits mentioned in the Auditor-General's biannual reports be grouped and discussed by portfolio. (Page 164)

56. The main results of efficiency audits be included in the Auditor-General's biannual reports on audits completed in the previous six months. (Page 163)

57. The Auditor-General publish in his annual report the costs of each audit including the costs of audits reported separately, such as efficiency audits and any special audits. (Page 66)

58. Auditees record audit costs in the notes to their financial statements. (Page 66)

59. The Auditor-General brief Ministers and the Prime Minister regularly on significant audit findings. (Page 199)

Contract Audits

60. The Auditor-General develop and publish a range of criteria on which to base any decision to employ auditors on contract. (Page 114)

61. Engagement letters to private sector auditors include the following requirements:

- . statements clarifying the nature of the review that the contracted auditor is expected to undertake - whether limited to the expression of an opinion on financial statements or whether concerned with authorisation of transactions, fraud, illegal transactions, adequacy of procedures to safeguard assets, or other;
- . statements indicating that the Auditor-General's agents will be required to conduct audits in accordance with standards devised by the Auditor-General. Audit standards were published by the Australian Audit Office in August 1987;
- . statements clarifying the matters on which an auditor is expected to report - whether irregularities, internal control weaknesses or fraud, and with what frequency;
- . statements clarifying to whom such reports should be directed - whether to ministers, management, and/or the boards of statutory authorities or companies or to audit committees of boards;
- . statements indicating that the contracted auditor will recommend to the Auditor-General the audit opinion to be expressed and submit to the Auditor-General a signed management letter on the audit results. Completed working papers including a recommended audit report will also be required; and
- . a statement indicating that the Auditor-General or his or her delegate will sign the audit report. (Page 115)

62. A condition of the award of a contract by the Auditor-General to a private audit firm be that the latter offers no other services to the auditee during the life of the audit contract. (Page 117)

63. The Auditor-General monitor the quality of contracted audits. (Page 119)

Private Sector

64. The Auditor-General discuss with the Australian Society of Accountants, the Institute of Chartered Accountants, and with accounting firms, the possibility of their augmenting the salary of staff who are recruited from the private sector for temporary appointment to Senior Executive Service positions in the Australian Audit Office. (Page 85)

65. The Auditor-General sponsor education and information programs in public sector audit with professional accounting bodies, audit firms, and tertiary education institutions. (Page 119)

66. The Auditor-General appoint a consultative or advisory committee with representatives from the private sector, universities and auditees. The committee would advise him on developments in private sector audit. It would assist in identifying emerging problems or issues, and would be a source of strategic advice including contracting of audits (section 11 of the Audit Act 1901). Further, the committee's terms of reference be drafted to avoid any impression that it would reduce the Auditor-General's independence and status. (Page 210)

67. The Auditor-General appoint a separate consultative or advisory committee on audit practices and standards. This committee would provide technical advice to the Australian Audit Office and ensure that the Audit Office's practices and standards were formed with knowledge of private sector practices without necessarily adopting those. This group may be a subcommittee of the major consultative or advisory group. (Page 211)

68. An interchange scheme be initiated wherein Australian Audit Office staff would work in private sector audit firms. (Page 211)

69. Membership of both of the major professional accounting bodies, the Institute of Chartered Accountants and the Australian Society of Accountants, be adequately represented amongst the Australian Audit Office's senior and other staff. (Page 213)

70. The Australian Audit Office commence negotiations immediately with the Institute of Chartered Accountants to permit young accountants who wished to become Institute members to have their professional training in the Audit Office. (Page 213)

Independent Auditor of the Australian Audit Office

71. Applicants for the position of Independent Auditor of the Australian Audit Office be selected from individuals who do not have current audit contracts with the Commonwealth Government, and further from a firm which does not have current contracts with the Australian Audit Office. (Page 216)

72. Future recommendations for appointment to the position of Independent Auditor be the responsibility of the Audit Committee of Parliament. The Governor-General would continue to have the power to appoint the Independent Auditor but on the advice of the Prime Minister who, in turn, would be advised by the Audit Committee of Parliament. (Page 217)

73. Appointment of Independent Auditor of the Australian Audit Office be for a minimum term of three years and a maximum term of five years. (Page 217)

74. The outgoing Independent Auditor make available to the incoming Independent Auditor relevant letters, working papers and other documentation to facilitate the change-over of auditors. (Page 217)

75. The Independent Auditor of the Australian Audit Office analyse the way in which the Australian Audit Office conducts its audits to determine if costs can be reduced to generate efficiency gains. (Page 50)

Other

76. The Australian Audit Office undertake an efficiency audit of internal audit in the Commonwealth sector. The efficiency audit should include a comprehensive survey of internal audit. (Page 206)

77. The Government and the Australian Audit Office adopt the former Senate Standing Committee on Finance and Government Operations' organisational classification. (Page 26)

78. The Australian Audit Office plan for a new building either within the Parliamentary Triangle or on State Circle adjacent to the new Parliament House, and that the building be called Audit House. (Page 246)

PART A
BACKGROUND

Chapter 1

INTRODUCTION

1.1 This inquiry was initiated because of a general concern by the Joint Parliamentary Committee of Public Accounts, JPCPA, with public sector auditing. A backdrop to the inquiry was constant Parliamentary attention to accountability and efficiency, as shown by the many revisions to the Audit Act 1901 in recent years. JPCPA concern was accelerated by the release in late 1987 of the Auditor-General's 1986-87 annual report on the Australian Audit Office¹ and by publication of the results of an efficiency audit of the Australian Audit Office conducted by the Independent Auditor^{2 3}.

1.2 The terms of reference for this inquiry were to investigate:

whether the Australian Audit Office had kept pace with developments in regard to the public audit function in the States and Territories and in comparable countries; and

whether current arrangements guaranteed the independence and resources necessary for the Australian Audit Office to fulfil its role as determined by the Audit Act 1901.

1.3 The inquiry commenced with no preconceived ideas about the Australian Audit Office. However, a critical belief was that Australia needed an efficient, effective and accountable Commonwealth sector, and the Australian Audit Office had a role in achieving this. In other words, the Public Accounts Committee,

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1. The Auditor-General, Annual Report of the Australian Audit Office 1986-87, AGPS, Canberra, 1987.
 2. E. Cameron, Report of the Independent Auditor on an Efficiency Audit of the Auditor-General's Office under the Audit Act 1901, AGPS, Canberra, 1987.
 3. The role of the Independent Auditor of the Australian Audit Office is described in Chapter 14.

PAC, believed that a strong Australian Audit Office was essential for good government. This perspective created two objectives for the inquiry:

to revitalise the AAO and redefine its role; and,
to increase debate about public sector auditing through removing its mystique.

1.4 Consequently, preparation of this report has been a vital task for the PAC, and goes to the very essence of public accountability.

1.5 The Auditor-General's Office was established in 1901 under provisions of the Audit Act 1901. Its name was changed to the Australian Audit Office in 1984. The AAO under either name had been reviewed twice previously in Royal Commissions established for other purposes.

1.6 The Royal Commission on Navy and Defence Administration and the Economies Commission were formed during the First World War⁴. Rapid expansion of government expenditure to meet defence obligations had led to problems in government agencies applying resources efficiently. The Royal Commissions were established partly to address those problems, and amongst their tasks they commented on some work of the Auditor-General's Office.

1.7 The Royal Commission on Australian Government Administration, RCAGA, which was formulated to inquire into and report upon the administrative organisation and services of the Australian Government, recommended changes to the Audit Act 1901⁵. Addition of efficiency audits to the Auditor-General's other responsibilities was the major change recommended. RCAGA did not review the Auditor-General's Office.

1.8 In other words, the last time the Audit Office was subject to any specific governmental or Parliamentary review was about 70 years ago, and then only for part of the Audit Office's role. This meant that the current PAC inquiry was the first Governmental or Parliamentary inquiry into the entire operations of the Australian Audit Office since its inception at Federation.

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4. Royal Commission on Navy and Defence Administration, Second Progress Report, Government Printer for the State of Victoria, Melbourne, 14 February 1918. Economies Commission Report, Government Printer for the State of Victoria, Melbourne, 1 July 1920.
 5. Royal Commission on Australian Government Administration, Report, AGPS, Canberra, 1976.

1.9 The Office of the Auditor-General of Canada was subject to a far-reaching review in 1975⁶. In the United Kingdom, the National Audit Office was reinvigorated after a major Parliamentary investigation⁷. New audit legislation, which was introduced into the New Zealand Parliament at the end of 1988, will have a dramatic effect on the work of that country's Auditor-General⁸.

Conduct of the Inquiry

1.10 The inquiry was announced in April 1988. Forty-seven submissions were received from:

individuals;

professional associations;

trade unions;

private companies;

Mr David Block, consultant to the Prime Minister and Cabinet;

Mr Kenneth Dye, the Canadian Auditor-General;

State and Territory Auditors-General;

Commonwealth Government organisations;

the former and present Independent Auditor of the Australian Audit Office;

the Acting Australian Auditor-General; and

the Australian Auditor-General.

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6. Report of the Independent Review Committee on the Office of the Auditor-General of Canada, Information Canada, Ottawa, March 1975.
 7. Refer to the following series of reports: Chancellor of the Exchequer, The Role of the Comptroller and Auditor-General, Her Majesty's Stationary Office, London, March 1980. First Special Report from the Committee of Public Accounts, Session 1980-81, The Role of the Comptroller and Auditor-General, Volume 1 - Report, Her Majesty's Stationary Office, London, February 1981. Chancellor of the Exchequer, The Role of the Comptroller and Auditor-General, Her Majesty's Stationary Office, London, July 1981.
 8. Finance and Expenditure Committee, Report of the Finance and Expenditure Committee on the Inquiry into Officers of Parliament, New Zealand Parliament, Wellington, New Zealand, 1989.

1.11 In addition, information was gathered from many national audit offices in other countries, including:

Canada;
Federal Republic of Germany;
Great Britain;
New Zealand;
Republic of Ireland; and
United States.

1.12 Ten public hearings were conducted in Canberra between June and December 1988. Appendix 1 lists submissions to the inquiry. The Committee met with a wide range of individuals and groups. Appendix 2 notes the dates of hearings and the identities of the 57 witnesses.

1.13 Despite all aspects of the Audit Office being subject to review, the inquiry focused on selected issues considered vital for the Audit Office's evolution. Selectivity was also necessary to make the review practical and the report timely.

1.14 The first term of reference required international comparisons. Consequently, the Committee or its staff met with:

the Canadian Auditor-General;
the New Zealand Deputy Auditor-General; and
the Chairman of the British Public Accounts Commission.

1.15 Emphasis in the international comparisons was on countries with parliamentary political systems. However, reference was made to developments in other political systems where appropriate.

1.16 It became apparent immediately that the role of the Auditor-General must be discussed prior to discussion of the Australian Audit Office. This was because only the Auditor-General had the authority to appoint persons to his Office, (Audit Act 1901, section 11). Consequently, this report is as much an analysis of the role of the Auditor-General as it is of the Audit Office.

1.17 Two kinds of audits are referred to in this study, as follows⁹:

regularity auditing which referred to audits that embraced all aspects of compliance with laws and regulations and of financial accountability; and

performance auditing which covered audits concerned with evaluation of the economy, efficiency and effectiveness of public sector management. Performance audits are also known as efficiency, project, or value for money audits.

Discoveries

1.18 A number of discoveries were made during the inquiry. First, as just suggested, the Australian Audit Office had not been reviewed even in part for many generations, and it had never been reviewed in its totality. Second, there was a complacency in political and administrative circles about the Audit Office's condition. Third, Commonwealth audit legislation needed a major overhaul.

1.19 When attention was focused on the Audit Office itself, further patterns appeared. The Audit Office:

had developed enormous expertise in public sector audit. Since the AAO had 88 years of experience, this should not have been surprising. However, it is stated here to place beyond doubt the Committee's views on this matter;

had a reputation for integrity. This reputation, which had been sustained for a very long time, was a most valuable asset for maintaining community confidence in government. Much of this report proposes ways to maintain and strengthen the integrity of the position of the Auditor-General and the Office;

was a powerful deterrent on illegal behaviour by public officials. Existence of the Auditor-General and his or her Office was not sufficient to stop

9. The definitions were derived by the International Organisation of Supreme Audit Institutions, INTOSAI. J Monaghan, In My Opinion: The Auditor-General's Approach to Performance Auditing, An Address by the Auditor-General of Australia, Mr J V Monaghan, to the Royal Australian Institute of Public Administration (ACT Division), 29 July 1987.

illegal acts and wasteful decisions by public servants. However, those aberrations would be more frequent if there were no Auditor-General. Maintenance of this deterrent role was important;

was respected by Parliamentarians from all parties because of the bipartisan way in which it carried out its tasks. Decisions and advice given by the Auditor-General and his staff were seen as being relatively unaffected by political considerations. Strengthening the capacity of the Auditor-General and his officers to remain politically neutral has been a major consideration of this report; and

was a means by which the public sector was kept accountable to Parliament.

1.20 These strengths or attributes were challenged by criticisms of the AAO. During the inquiry it was alleged that the AAO:

asked the wrong questions. It was concerned with the pennies and not with the pounds. This view was of the AAO's alleged adherence to scrutiny of line item budgeting at the expense of the larger questions of efficiency and effectiveness of resource usage;

it was intrusive. Excessive emphasis on performance auditing involved access to management decisions on non-financial matters;

it was ill-informed. Auditors did not have the technical training to assess decisions in areas as diverse as meteorology, the construction of large buildings or military administration;

it was out of date. Auditors did not have sufficient knowledge of the private sector milieu in which many government enterprises functioned. Furthermore, public sector auditing lagged developments in the private sector; and

the AAO was unstable. High levels of staff turnover in the AAO often meant that different auditors were assigned annually to the same audit. This was inefficient since new auditors then had to familiarise themselves with the account each year.

1.21 During the course of the inquiry, the Committee explored these criticisms in details.

Need for an Auditor-General and a National Audit Agency

1.22 One of the advantages of having the Auditor-General between auditees and Parliament is that Parliament can rely on the Auditor-General to identify or to filter the most important audit issues. On the basis of his advice, Parliament may pursue or ignore an issue. The Auditor-General's presence does not stop Parliament from disagreeing with his opinion, but usually his assessment of the importance of audit issues is a starting point for Parliamentary consideration. This function justifies the position of Auditor-General and the maintenance of his or her Office.

1.23 In the unlikely event that Parliament were to abolish the Australian Audit Office and allocate audit tasks to private audit firms, very large numbers of individual reports would go to Parliament, which would have the task of identifying the most important issues. Such an arrangement would not exist for very long before another 'filter' with the same functions was put in place to assist Parliament in sorting through audit issues.

Accountability and Efficiency

1.24 Much of this report discusses the Audit Office's role in maintaining the accountability of federal officials and the public sector to Parliament. Accountability to Parliament means that federal officials are answerable to Parliament for their actions and decisions. In other words, maintenance of accountability maintains Parliamentary authority over the public sector.

1.25 Accountability cannot be measured like the amount of water in a glass. However, there can be varying degrees of accountability. The report notes this and makes a distinction between necessary and sufficient accountability. Also noted was disagreement in various circles over what was sufficient accountability of federal officials to Parliament. It was found that the adequacy of provisions for maintaining accountability varied with different kinds of Commonwealth organisations.

1.26 One set of problems which the inquiry encountered was the relationship between accountability and efficiency in the public sector. An efficient public sector was one which used the

least possible resources to achieve the desired effect. One set of views was that there was a trade-off between efficiency and accountability: that is, the push for greater accountability was a barrier to development of a more efficient public sector. In other words, accountability and efficiency coexisted, but an increase in one led to or was associated with a decrease in the other.

1.27 The Committee could see no necessary conflict between accountability and efficiency. It acknowledged, however, that political decisions, first, could determine the efficiency with which a government organisation applied its resources, and second, could define the goals and criteria by which the organisation's effectiveness could be assessed. Objections to the right of Parliament to influence the efficiency and effectiveness of bodies which it created were misguided. Australian Governments of all persuasions have made such decisions and will continue to do so. The reality is that political considerations in all countries affect the operation of organisations established by statute. Of course, though, there are varying degrees of political control in existence.

1.28 Many believers of an inverse relationship between accountability and efficiency were looking for ways to reduce government controls. Without necessarily sharing their beliefs, the Committee has argued that controls which reduce the efficiency of government organisations for no good reason should be revised. The Committee noted the Government's announcements in the 1988 May Economic Statement reducing controls on government business enterprises in the Transport and Communications Portfolio.

1.29 Some argue that the most accountable government organisations (presumably Departments of State) have low levels of efficiency, and that the least accountable organisations (for instance, government companies) are the most efficient. No empirical evidence was presented to the Committee to support such claims. However,, there is some evidence to suggest that if government business enterprises operate in a truly competitive environment, some greater efficiencies are obtained.

1.30 Reduction in government controls has no effect on the obligation of officials in those organisations to be answerable to Parliament for their decisions. If anything, a justifiable reduction in executive government's control over the daily operation of those government business enterprises strengthened the need for their accountability to Parliament in order that the latter could be guaranteed that those enterprises were achieving their objectives, whether those were set by the enterprises themselves or by Parliament.

1.31 The Auditor-General has a vital role to play in this debate because he has the authority to ask how efficiently are

government agencies applying their resources. He also has the means to answer that question and to inform Parliament directly. This inquiry has upheld his right to ask that question, and has sought to strengthen his capacity to form an opinion on this matter.

New Interest in Accountability in Government

1.32 This report was written while State government reports with auditing and accountability implications were published. These reports included:

New South Wales Commission of Audit, Focus on Reform: Report on the State's Finances¹⁰;

The Report to the Premier by the Commission on Accountability established by the Western Australian Government¹¹; and

Report of the Inquiry into the Victorian Economic Development Corporation¹².

1.33 Release of these reports pointed to a sharpened awareness of the need to maintain and strengthen the accountability of officials and governmental organisations.

Acceptable Audits

1.34 Auditees considered a good audit one which found nothing wrong. Auditors were satisfied if their findings justified their effort. Parliament was pleased if the audit showed that laws were complied with and/or resources used efficiently. Existence of three stakeholders in each audit guaranteed the likelihood of disagreement on the characteristics of a quality audit. Surprisingly, then, stakeholders often agreed on what were quality audits. Nevertheless, acceptance of the reality of conflict over audits was essential to understanding the functions of the Auditor-General and his Office. Such acceptance also helped the Committee make sense of the various views put to it on the work of the Audit Office.

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10. New South Wales Commission of Audit, Focus on Reform: Report on the State's Finances, Government Printer, New South Wales, Sydney, 1988.
 11. Commission on Accountability, Report to the Premier the Honourable P McC Dowding LL.B. MLA., Commission on Accountability Perth, 1989.
 12. Ryan, F., Report of Inquiry, Victorian Economic Development Corporation, Melbourne, 1989.

1.35 It was important to affirm that Parliament, not auditees, was the Auditor-General's client. Some government officials and organisations did not appreciate this. A related issue was whether the Auditor-General could serve Parliament and assist auditees at the same time. The affirmative answer to this question also pointed to how the views of various stakeholders on what was a good audit could be brought closer together without necessarily being the same.

Structure of the Report

1.36 The report is in five parts. Part A, Background, contains this introduction and a brief history of the Australian Audit Office. A history was necessary to provide a broader perspective on changes advocated in this report. Of note was the paucity of academic studies of public sector auditing. More studies are necessary of how the function of audit in government has changed. Other chapters provide basic facts such as information on the number of audits the AAO conducts annually and the costs of audits. A critical question raised was whether resources for public sector audit are adequate.

1.37 Part B, Major Changes, examines different methods of funding national audit offices and highlights the impact on their independence. A closer relationship between Parliament and the Auditor-General is advocated, with Parliament taking a greater interest in the Audit Office's estimates. Appointment of the Auditor-General and Audit Office staff is examined. This part of the report asks which government organisations the Auditor-General should audit, or what are and should be the limits of the Auditor-General's responsibilities. Accountability provisions of the Audit Act and the Companies Act and Code are compared. The contracting of audits by the Auditor-General to private sector auditors is also discussed. The final major issue raised is audit of the \$11 billion in Commonwealth specific purpose grants to State and Territory governments.

1.38 Part C is a review of performance audits. Efficiency audits are the most well-known form of performance audits. Project audits are less visible although as many resources are devoted to them as to efficiency audits.

1.39 Part D, Selected Issues, focuses on acceptance and implementation of audit findings, internal audit, private sector and professional relations, and responsibilities of the Independent Auditor of the Australian Audit Office.

1.40 Part E, The Future, proposes a new funding arrangement and a funding increase for the Audit Office, and advocates the need for a new audit act.

Chapter 2

A BRIEF HISTORY OF THE AUSTRALIAN AUDIT OFFICE

Origins

2.1 In 1901, the year of Federation, the Audit Act established a legislative basis for the financial management of Commonwealth moneys and a legislative basis for the audit of related accounts¹. The Act was the fourth to be passed by the first Federal Parliament, indicating its high importance.

2.2 In his Second Reading Speech on the Audit Bill, Sir George Turner, the Treasurer, stated that²:

It was wise and necessary that a uniform system with regard to the receipt and payment of moneys, and the audit of the public accounts, should be established throughout the Commonwealth.

2.3 He argued that it was necessary:

that we should provide the best checks we can get in regard to all dealings with public moneys, and especially in regard to disbursements, in order to prevent frauds and defabrications.

2.4 The Act provided a legal foundation for appointment of an Auditor-General, who was given power to appoint inspectors for the purpose of having the books of the various departments kept in good order. He was also given the authority to create his own Office. The inspectors were officers of the Audit Department and were attached to the larger departments such as the Post Office

1. Audit Act 1901.

2. Commonwealth of Australia, Parliamentary Debates, Session 1901-2 (First Session of the First Parliament, Vol.1) Senate and House of Representatives, Government Printer for the State of Victoria, Melbourne, 1901, pp.1247.

and Customs, to make an audit of the accounts daily. Part II of the Act which gave him this authority still applies as the foundation of the Australian Audit Office.

2.5 The first Auditor-General, a former State Auditor-General, was appointed in December 1901, and 16 staff were recruited to his Office in the next few months. Of note in the Auditor-General's first annual report was his acknowledgement of the staffing assistance provided by the Treasury. The Treasury's role on this matter has been taken over in recent times by the Department of Finance.

2.6 The Act became effective from the beginning of 1902, but, to give the Auditor-General time to establish his Office, all Commonwealth accounts from Federation until June 1902 were examined by State Auditors-General³. The Office was responsible for audit of all Commonwealth departments and instrumentalities. The Departments were:

- External Affairs
- Attorney-General
- Home Affairs
- Treasury
- Trade and Customs
- Defence
- Postmaster-General

2.7 The Audit Act was amended in 1906 to relieve the Auditor-General of the necessity of auditing accounts at short intervals where the audit cost was disproportionate to the amount involved.

2.8 In 1911, the Auditor-General's Office was included under the Prime Minister's Portfolio for administrative and budgetary purposes. This arrangement continued for 75 years until the 1985-86 financial year. Since then, appropriations for the Australian Audit Office, AAO, have been included within the Finance Portfolio.

2.9 The Commonwealth Public Accounts Committee was formed in 1913. This followed a general election in which one issue was the financial methods of the retiring Government which had been trenchantly criticised by the Opposition. Formation of this Committee was an important step in the development of means to make government more accountable to Parliament.

3. B. Cathro, History of the Australian Auditor-General's Office, 1901-1980, CCAE, Canberra, 1980.

Early Views on Resources and Independence

2.10 The Royal Commission on Navy and Defence Administration in 1918 accused the Auditor-General of failing⁴:

... in his duty to the public in not strenuously representing to Parliament that his inability to secure a sufficient staff of suitable officers precluded him from conducting an effective and up-to-date audit. The fact that he was content with a more formal compliance with his statutory duties shows that he did not realise the extent of his responsibility. We consider that if he had reflected on the results that might be expected to accrue from the belated condition of his audit, he would have realised the necessity for a more vigorous policy, and more insistent demand for his right to be provided with adequate assistance...

2.11 The Auditor-General replied to the Royal Commission in strong terms⁵.

With respect to the opinion of the Commission that the Auditor-General failed in his duty to the public in not "strenuously representing" to Parliament his inability to secure a sufficient staff raises the question as to how far the Auditor-General should go in making such representations. That depends upon circumstances, and requires the exercise of fact and discretion. In the case under review, it involved reference to the action of the Cabinet, the Prime Minister's office, the Right Honourable the Treasurer, and the Public Service Commissioner, considerations of the insistent demand for economy, and of Government policy. There was no open and absolute refusal to supply the Auditor-General with the assistance he required. There was certainly delay, and that delay continues, owing... (partly) to the restrictions which Government policy has imposed in connection with conditions of employment.

2.12 The ensuing debate led to a request from the Prime Minister to the Auditor-General soliciting his views on the

4. Royal Commission on Navy and Defence Administration, op.cit.
5. Special Report of the Auditor-General on Amendments of the Audit Act and Position and Status of the Auditor-General, the Parliament of the Commonwealth of Australia, 1917-18-19, Government Printer for the State of Victoria, Melbourne, 1919.

status or independence of the Auditor-General. Relevant to the current JPCPA inquiry⁶ is that the Auditor-General was also requested to furnish information as to the position in the States and in Great Britain⁷.

2.13 The Secretary to the Treasury was also invited to give his views on the independence of the Auditor-General. He wrote that⁸:

Carried to its logical conclusion, the contention of the Royal Commission and the Auditor-General requires that the Auditor-General shall himself decide how much shall be spent on Audit, and the Minister would be compelled to place upon the Estimates just what the Auditor-General indicated. That would be a subversion of Ministerial responsibility, and would be antagonistic to representative government.

2.14 The Secretary to the Treasury went further to affirm that:

The Commission and the Auditor-General seem to have overlooked the fact that Ministers (especially the Treasurer) are closely concerned in the maintenance of an effective audit and are not likely to interfere unnecessarily in arrangements of staff.

The Auditor-General has been placed by the Audit Act in a very strong position, and his right to report at any time direct to Parliament is a sufficient safeguard against undue interference. Greater power seems neither necessary nor desirable.

2.15 The question of the Auditor-General's independence was also raised by the 1918 Royal Commission⁹:

We consider that those sections of the Audit Act which attempt to detail the Auditor-General's

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6. The first term of reference for the current inquiry is to investigate whether the Australian Audit Office has kept pace with developments in regard to the public audit function in the States and Territories and in comparable countries.
 7. M Shepherd to Auditor-General, Special Report, op. cit., 6 June 1918.
 8. J Collins to the Secretary, Prime Minister's Department, Special Report, op. cit., 30 December 1918.
 9. Special Report, op. cit.

duties should be eliminated. The Act should require the Auditor-General to conduct an audit of all the financial operations of the Commonwealth Government, but the procedure and scope of the audit should be left to his discretion.

2.16 There was some debate about whether the Auditor-General should be the permanent head of a separate Department outside the operations of the Commonwealth Public Service Act. The Commonwealth Public Service Commission argued against this proposal, while the Auditor-General supported it.

2.17 The Auditor-General's administration of his Office was also criticised to some extent by the Economies Commission established towards the end of the First World War. The Auditor-General and other senior staff responded in strong terms to these criticisms¹⁰.

2.18 A consequence of this attention was that the Audit Act was amended in 1920 to permit the Auditor-General further discretion in the extent of his audits. Further change was that from 1922 the Auditor-General was given the authority of a permanent head of a department under the Commonwealth Public Service Act. Previously this authority was exercised over the Auditor-General's Office by the Secretary of the Department of the Prime Minister.

2.19 In 1923, increased responsibilities were given to chief Commonwealth auditors in the States. At that time, cash books for receipts and expenditures were still subjected to a 100 per cent check. Discretion was extended over the amount of detailed checking of transactions resulting in a decrease in the amount of this work.

2.20 The first Auditor-General died in office in 1926 after 25 years in the role. A successor was appointed¹¹.

Evolution of Responsibilities

2.21 During the Second World War (1939-1945), the responsibilities of the Auditor-General and his Office increased with the very rapid growth in Commonwealth expenditure and with the proliferation of new Commonwealth organisations to support the war effort. It was increasingly difficult for the

10. Economies Commission, op. cit., Remarks by the Auditor-General and Certain Officers of his Staff on the Commission's First Progress Report, in So Far As the Audit Office is Concerned.

11. Appendix 3 lists Australia's Auditors-General.

Auditor-General to maintain staff since these were recruited into the armed forces. Thus, discretionary reduction of audit checks and examinations became more acceptable¹².

2.22 In 1948 after the War ended, the Office was reorganised and the establishment increased. In the same year, further discretion was granted to the Auditor-General with the passage of an amendment to the Act. Section 45B stated that:

The Auditor-General may, at his discretion, dispense with all or any part of the detailed audit of any accounts.

2.23 The relationship between Parliament and the Auditor-General was more clearly defined with passage of the Public Accounts Committee Act¹³. Section 8 (1) of the Act requires the Committee -

(a) to examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of Section 50 of the Audit Act 1901;

...

(ab) to examine all reports of the Auditor-General...

2.24 In the same year, there was heated disagreement between the Speaker of the House as to the Auditor-General's right to audit accounts of the Parliament itself. The issue was the limit of the Auditor-General's mandate. This critical issue was resolved in the Auditor-General's favour when the Prime Minister tabled a statement in Parliament in 1952 which indicated that the Audit Act applied to the audit of the Parliament's accounts.

2.25 Commonwealth revenue and expenditures increased considerably after the Second World War, with a corresponding rapid increase in the number of financial transactions. It was no longer possible to check every financial transaction because of their great number. A new approach to auditing was developed, wherein the purpose of the audit was to ensure compliance with procedures determined by the Treasury in its administration of the Audit Act.

2.26 Technological innovation in financial administration

12. It is likely that responsibility for financial management was devolved to line managers during the war because of war-time exigencies.
13. Public Accounts Committee Act 1951.

led to the establishment in 1963 of an Audit Office division for audit functions related to electronic data processing. Audit planning became more formalised. The Office was reorganised at the end of the decade with different divisions responsible for the audits of particular departments and other government organisations. In addition, more authority was decentralised to regional offices in the States.

2.27 Audit workload continued to increase leading to a large 44 person increase in establishments in 1975.

2.28 Amendments to the Audit Act of great significance were passed in 1979. Until then, audit and reporting requirements were only contained in specific acts relating to auditees¹⁴. Previously, the Auditor-General was not legally empowered or required to report on those audits to the Parliament in his annual report although in reality he did so. Surprisingly then, it was not until 1979 that amendments were passed to the Audit Act authorising the Auditor-General to report on financial statements. In other words, legislation lagged audit practice.

2.29 The amendments extended the Auditor-General's mandate to include efficiency audits of Government departments. In the then Auditor-General's opinion, this was the most significant innovation in the Office's responsibilities since Federation. Initially a separate efficiency audit division was formed within the Audit Office¹⁵. However, this division was disbanded within a few years and responsibilities for efficiency audits distributed across those divisions with responsibility for the audit of particular groups of government organisations. Decentralisation of efficiency audits was consistent with the prevailing philosophy of integrating performance and financial audits as comprehensive audits.

2.30 In 1984, the name of the Auditor-General's Office was changed to the Australian Audit Office.

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14. T. Jambrich, The Changing Emphasis in Public Sector Audit Reporting from the Australian Audit Office Perspective, Conference of the Accountability Interest Group of the Accounting Association of Australia and New Zealand, 1988.
15. P Hamburger, Efficiency Auditing by the Australian Audit Office: Reform and Reaction Under Three Auditors-General, John F. Kennedy School of Government, Harvard University, Cambridge, MA, 1987.

Chapter 3

RESPONSIBILITIES AND RESOURCES

3.1 This Chapter presents statistical data on the Australian Audit Office's, AAO's, responsibilities and resources. It argues that public sector audit is conducted in a more complex environment than in the 1960s and 1970s and notes some important changes that have taken place in audit, asks whether current resources are adequate for the conduct of public sector audit, and finally describes how successive Auditors-General have exercised their responsibilities with limited resources.

How Many Audits Does the Australian Audit Office Conduct?

3.2 Table 3.1 demonstrates the enormity of the task confronting the Auditor-General. In 1988 he was responsible for the audit of:

323 organisations which had an estimated 505 100 staff;

42 programs with budgets greater than \$1b;

10 programs with budgets between \$501m and \$1b;

an additional 774 programs; and

960 data processing installations.

3.3 These organisations had¹:

an expenditure of \$112.4b; and

revenue of \$117.7b;

1. In this Chapter, all dollar amounts are in 1987-88 values unless otherwise indicated, and 'b' means 1000m.

TABLE 3.1

Size of Audit Task: 30 June 1987 and 30 June 1988¹

Organisations/ Programs/DP Installations	1987	1988
No. of Organisations	298	323 ²
Total Expenditure \$b	104.5	112.4
Total Revenue \$b	106.6	117.7
Total Assets \$b	104.9	115.1
Total Liabilities \$b ³	76.5	79.1
Staff Numbers (est)	501.4	505.1
No of Programs		
- Over \$1000m	40	42
- \$501-\$1000m	11	10
- \$100-\$500m	59	69
- \$10-\$100m	231	229
- Up to \$10m	467	476
Total Programs	808	826
No of DP Installations ⁴	701	960

1. The Auditor-General, Annual Report of the Australian Audit Office 1987-88, AGPS, Canberra, 1988.
2. Tables 3.3 and 3.6 indicate that there are 343 auditees. Twenty of these are not separate organisations but superannuation funds of larger organisations or external activities.
3. The value of assets and liabilities for departments and other branches of the Australian Public Service are not available.
4. Refers to the number of DP hardware systems within the Commonwealth and may include networked minicomputers. It does not refer to stand alone microsystems or computer systems applications.

TABLE 3.2

Audits of Commonwealth Government Organisations, 1987-88¹

Type of Commonwealth Government Organisation	Number of Audits ²						Total
	Accounts and Records	Financial Statements	Project Audits ⁴	Efficiency Audits			
Departments and Outriders	0 ³	1	n.a ⁵	6		7	
Departmental Commercial Undertakings	10	19	n.a	0		29	
Statutory Authorities	108	104	n.a	2		214	
Companies	52	68	n.a	0		120	
Total	170	192	181	8		551	

1. The Auditor-General, Annual Report 1987-88, op. cit.

2. Refer to the number of audit reports issued. These reports may combine the results of one or more audit tasks.

3. The term accounts and records derives from the standard provisions for audit of statutory authorities, e.g. Section 63G of the Audit Act. The term is not used in respect of the audits of departments and their outriders which rely on broader provisions of the Audit Act.

4. It was not possible to separate project audits which were part of regularity audits, from project audits which were part of performance audits.

5. Data for project audits were not available by type of Commonwealth Government organisation.

3.4 Table 3.2 shows that in 1987-88, the Audit Office completed 551 audits, including at least:

7 audits of departments and their outriders²;
29 audits of departmental commercial undertakings;
214 audits of statutory authorities; and
120 audits of government companies.

3.5 Of the 551 audits:

170 were audits of accounts and records;
192 were audits of financial statements;
181 were project audits; and
8 were efficiency audits.

3.6 Longitudinal data were not available to determine whether the AAO conducted more audits in 1987-88 than, for example, five or ten years previously.

3.7 Table 3.3 shows that from 1978 to 1988:

the number of departments and their outriders rose from 93 to 104, while their percentage of all government auditees fell from 47.9 per cent to 30.3 per cent. Notwithstanding, only one audit was conducted of these in 1988 as in 1978. This was the audit of the financial statements prepared by the Minister for Finance; and

the number of other government organisations, (departmental business undertakings, statutory authorities and government companies) more than doubled from 101 to 239, while their percentage share of all government organisations subject to audit rose from 52.1 per cent to nearly 70 per cent.

2. Outriders included organisations such as the Australian Development Assistance Bureau, Australian Taxation Office, Bureau of Meteorology, Export Grants Development Board, Defence Science and Technology Organisation, the Schools Commission and the Australian Audit Office itself.

TABLE 3.3

AAO Auditees by Auditee Type, 1978-79, 1988-89¹

Auditee Type	1978-79		1988-89	
	No.	%	No.	%
Departments	31	16.0	23 ²	6.7
Departmental Outriders	51	26.3	62	18.1
Miscellaneous	11	5.6	19	5.5
Sub-Total	93	47.9	104	30.3
Departmental Undertakings	4	2.1	19	5.5
Statutory Authorities	78	40.2	108	31.5
Companies	19	9.8	112	32.7
Sub-Total	101	52.1	239	69.7
Total	194	100.0	343	100.0

- 1. C Monaghan to Secretary, JPCPA, 11 August 1988.
2. Includes Parliamentary departments.

3.8 Table 3.1 also records the strong growth in AAO responsibilities from 1987 to 1988. In 1987, the AAO was responsible for the audit of 298 organisations compared with 323 in 1988; 808 programs compared with 826 in 1988; and 701 computer installations compared with 960 one year later.

3.9 Of note is that although the AAO's classification of government bodies has in general, been used in this report, the PAC believes that the classification devised by the former Senate Standing Committee on Finance and Government Operations is clearer. Discussions of matters of interest to this inquiry have sometimes been confused because of use of more than one classification system. It is important that terminology used to describe government agencies should be standardised to avoid this problem.

3.10 The Committee recommends that:

The Government and the Australian Audit Office adopt the former Senate Standing Committee on Finance and Government Operations' organisational classification³.

What Is the Value of Financial Transactions Audited by the Auditor-General?

3.11 The size of the audit task can be indicated by the value of Commonwealth financial transactions subject to audit⁴. Table 3.4 shows that in the ten years from 1978-79 to 1988-89, the value of Commonwealth financial transactions in respect of both the general government sector and public trading enterprises expressed in 1987-88 dollars, varied as follows:

total Commonwealth expenditure increased from \$71.2b to \$96.8b;

total Commonwealth revenue increased from \$63.7b to \$98.9b; and

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3. Refer to Senate Standing Committee on Finance and Government Operations, List of Commonwealth Bodies, AGPS, Canberra, 1987; Non Statutory Bodies, AGPS, Canberra, 1986.
 4. Another indicator may be the number of payroll and non-payroll transactions processed in the Department of Finance's Ledgers System and audited. The Department of Finance's 1987-88 annual report described the Finance Ledger System: Department of Finance, 1987-88 Annual Report, AGPS, Canberra, 1988.

TABLE 3.4

Commonwealth Sector Receipts and Expenditure and Commonwealth Expenditure on External Audit
1978-79 to 1988-89¹

Year	Total C'wealth. Expend. \$b.	Total C'wealth Revenue \$b.	Total C'wealth Expend. and Revenue ² \$b.	Per Cent Variation	C'wealth AAO Staff Costs \$m.	Total C'wealth Expend on AAO \$m.	Per Cent Variation ³
78-79	71.2	63.7	134.9	100.0	20.8	22.9	100.0
79-80	71.4	66.8	138.2	102.4	20.7	23.1	100.0
80-81	74.1	71.6	145.7	108.0	22.2	24.8	108.3
81-82	79.6	76.4	155.9	115.6	24.0	26.5	115.7
82-83	84.3	75.3	159.6	118.3	21.5	24.1	105.2
83-84	90.7	77.4	168.0	124.6	21.3	24.7	107.9
84-85	97.5	87.1	184.5	136.8	21.4	24.8	108.3
85-86	99.1	89.7	188.8	140.0	21.8	26.1	114.0
86-87	98.0	92.6	190.5	141.2	21.6	25.8	112.7
87-88	96.3	97.3	193.6	143.5	21.0	24.7	107.8
88-89 (est)	96.8	98.9	195.6	145.0	20.6	32.3	141.0

1. Australian Audit Office, Submission by the Australian Audit Office to the Inquiry Reform of the Australian Audit Office, AAO, Canberra, May 1988, p. 355. D Hill to Secretary, JPCPA, 9 September 1988: Department of Finance, Explanatory Notes 1988-89 Finance Portfolio, Budget Related Paper No. 8.7, Department of Finance, Canberra, 1988.

2. Columns may not total because of rounding.

3. Constant dollars were calculated using the CPI. A better deflator was the Implicit Price Deflator used in Government Final Expenditure Deflator, Australian National Accounts, National Income and Expenditure, (ABS. 5206.0). The Implicit Price Deflator was used to express Commonwealth Budget Outlays, which were a component of the above financial transactions, in constant dollars. Those figures, which are not reported here, showed similar trends to those displayed above.

total expenditure and revenue increased from \$134.9b to \$195.6b which was a 45 per cent increase.

3.12 These are conservative estimates of the dollar value audited by the Auditor-General because of the exclusion from the Table of:

public financial enterprises such as the Reserve Bank, Commonwealth Bank and some primary industry marketing boards;

the value of assets and liabilities for all statutory authorities and companies; and

the value of the assets of Commonwealth departments and outriders.

3.13 These exclusions also make it very difficult to give a consolidated picture of the Auditor-General's responsibilities⁵. Appendix 4 provides more detailed information.

3.14 Table 3.4 included Commonwealth payments to State and local government. Audit of some of these grants, such as general revenue and capital grants, currently requires few resources and there are grounds for giving them less attention in measurement of the Audit Office's mandate⁶. On the other hand, Commonwealth specific purpose grants to other levels of government require more detailed auditing and should be included in measurement of Audit Office workload. Net Commonwealth payments of all kinds to other levels of government constitute an important but declining proportion of total Commonwealth Budget outlays⁷. Such payments accounted for slightly more than 30 per cent of total Commonwealth Budget outlays in 1987-88. Overall, the ratio of payments to other levels of government to total Commonwealth Budget outlays has declined steadily since the mid-seventies. Therefore, if these were excluded the value of combined Commonwealth expenditures and revenue would be less than in Table 3.4, but there would be an even greater rate of increase in the combined residual total of revenue and expenditure.

5. These also are the reasons for the differences between the amounts in Tables 3.1 and 3.4. Other possible reasons for the differences included differences in the timing of AAO and ABS data collections, and transfer payments from one part of a portfolio to another, such as from a department to a departmental commercial undertaking.

6. Audit of section 96 grants will be discussed in Chapter 9.

7. Commonwealth Financial Relations with Other Levels of Government 1987-88, Budget Paper No 4, AGPS, Canberra, 1988, p.11.

TABLE 3.5

Estimates of the Value of Assets and Liabilities of Statutory Authorities and Companies, 1985-86 - 1987-88.¹

Commonwealth Body and Year	Assets \$b	Liabilities \$b	Total ² \$b
Statutory Authorities			
85-86	80.2	58.6	138.8
86-87	99.1	72.4	171.5
87-88	109.4	74.6	184.0
Companies			
85-86	4.1	3.4	7.5
86-87	4.4	3.7	8.1
87-88	4.6	3.8	8.4

1. D Hill, op. cit., 9 September 1988.

2. No account was taken of the fact that some accounts were based on cash accounting and others on accrual accounting. Therefore, these estimates were not necessarily in 1987-88 dollars.

3.15 Table 3.5 provides an indication of the value of assets and liabilities of all statutory authorities and companies. 1978-79 data were unavailable so data from a more recent period were reported. Table 3.5 shows that from 1985-86 to 1987-88:

the value of the assets and liabilities of statutory authorities increased from \$139b to \$184b; and

the value of the assets and liabilities of government companies increased from \$7.5b to \$8.4b.

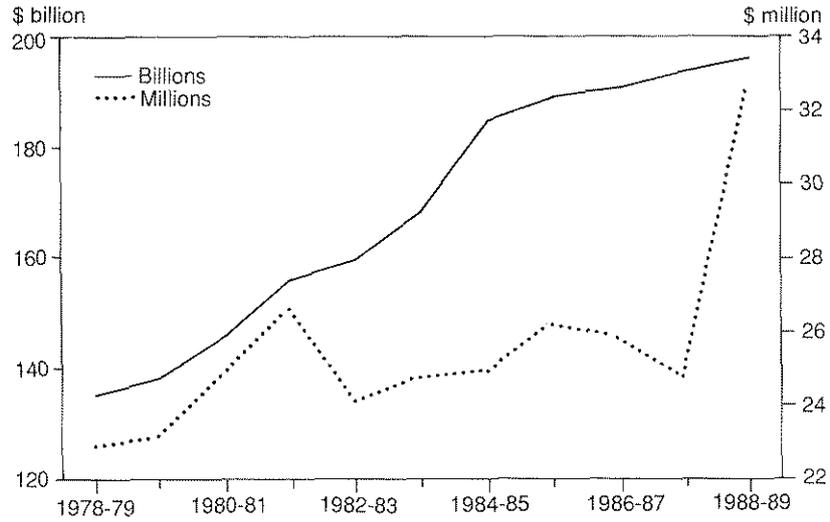
Have Resources Available to the Australian Audit Office Kept Pace with Growth in Commonwealth Financial Transactions?

3.16 Since 1977-78 the numbers and kinds of government activities have grown rapidly. For instance, the number of statutory authorities and companies subject to AAO audit has increased from under 100 to more than 200, (Table 3.3). Allied with this is rapid growth in the number of financial transactions undertaken by officials.

3.17 Figure 3.1 displays Table 3.4 graphically. Figure 3.1 shows that, in constant dollar terms, Commonwealth allocations to the Audit Office rose from \$22.9m in 1978-79 to \$24.7m in 1987-88. This was an 8 per cent increase for a period in which the value of Commonwealth financial transactions rose by 40 per cent. Commonwealth outlays on the Audit Office increased to \$32.3m in 1988-89. This was a 41 per cent increase from 1978-79 to 1988-89 when the value of Commonwealth financial transactions rose by 45 per cent. Most of the increased expenditure on the AAO from 1987-88 to 1988-89 was because of the AAO's purchase of a computer. Of some significance was that the Commonwealth spent more on AAO salaries in 1978-79 than in 1988-89 (\$20.8m vs \$20.6m).

3.18 Figure 3.1 in no way purports to define a relationship between the size of any single account and the resources that should be allocated to the audit. Resources allocated to each individual audit are a matter for the Auditor-General's judgement.

FIGURE 3.1 Total Commonwealth Revenue and Expenditure and Commonwealth Expenditure on External Audit, 1978-79 to 1988-89¹



¹ All dollar amounts are in 1987-88 values.

3.19 The data show that in 1978-79:

the cost to the Commonwealth of every \$1000 subject to audit was 16.5 cents; and

\$1 expenditure on external audit provided coverage of \$5890 in Commonwealth funds.

3.20 In 1987-88:

the cost to the Commonwealth of every \$1000 subject to audit was 16 cents; and

\$1 expenditure on external audit provided coverage of \$6055 in Commonwealth funds.

3.21 Actual costs were lower because of exclusion from these calculations of assets and liabilities.

3.22 It is clear that the value of Commonwealth outlays on audit relative to the size of the audit task has remained approximately constant.

3.23 Table 3.6 provides information on the number of Government departments, statutory authorities, government business enterprises and other Government organisations subject to AAO audit, and also provides information on AAO staffing levels. The patterns were as follows:

from 1977-78 to 1987-88, the number of government bodies subject to audit increased from 196 to 343;

in 1977-78, 3 AAO staff, or 2.3 professional staff, were available for the audit of each of these organisations; and

in 1987-88, 1.7 AAO staff, or 1.3 professional staff, were available for each organisation.

3.24 All other factors being equal, this pointed to a possible 43 per cent rise in staff productivity over ten years to maintain the same degree of audit coverage.

TABLE 3.6

Organisations and Financial Activities Subject to Audit by the
Australian Audit Office and AAO Staff Numbers, 1977-78, 1986-87
and 1987-88¹

Year	Organisations & Activities Under AAO Audit Mandate	AAO Audit Staff	Per Cent of Total Staff ²	Other AAO Staff	Total AAO Staff
77-78	196	457	78.3	127	584
86-87	318	497	80.6	120	617
87-88	343	458	77.5	133	591

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1. Auditor-General, Report of the Auditor-General, Accompanied by the Statement of Receipts and Expenditure Presented by the Minister for Finance for the Year Ended 30 June 1978, AGPS, Canberra, 1987, pp. 297. Auditor-General, Annual Report of the Australian Audit Office 1986-87, AGPS, Canberra 1987.
 2. AAO Submission, op. cit., p.362.

How Has the Financial, Political and Administrative Environment for Audit Changed Since the 1960s and 1970s?

3.25 Over the last ten years the financial environment for audits has changed, as follows:

financial markets were deregulated and the Australian dollar floated. These initiatives required changes in the operation of particular kinds of government enterprises such as trading authorities;

the speed of technological change in management of financial and other resources has accelerated so that demands on auditors are even greater;

greater numbers of public sector bodies were required to operate on a commercial basis with allied change in their financial controls;

stricter accounting and reporting requirements were introduced in the public sector, with Department of Finance, DOF, advocacy of Australian Accounting Standards;

a greater number and complexity of accounting standards were issued by professional bodies;

government companies formed many more subsidiaries. Parent companies decide whether subsidiaries will be audited by the Auditor-General. Some have chosen other auditors;

the machinery of government was changed with greater devolution of authority to departmental secretaries. Departmental secretaries now are responsible for devising and implementing financial control systems, so that where previously there was the same DOF system in place in every department and related agency, now there is a variety of financial systems; and

new legislative requirements were introduced.

3.26 Clearly, compared with the 1960s and 1970s, public sector audits are conducted in a more complex environment. The

diversity of modern financial arrangements and the wealth of regulatory material places increasing demands on the government auditor in keeping abreast of the requirements of his or her profession.

3.27 Government financial management and the efficiency of Government resource allocation may have improved as a result of the changes listed above. Regrettably, however, improvements in the efficiency of government operations have been accompanied by marked increases in the amount of fraud and white collar crime. Official concern with the severity of fraud in government is very high as indicated by, for example:

the Royal Australian Institute of Public Administration's Conference in May 1988 on 'Ethics, Fraud and the Public Service';

the Australian Institute of Criminology Conference in July 1988 on 'Fraud in Government';

the report of the Special Minister of State, Review of Systems for Dealing with Fraud on the Commonwealth⁸; and

the Attorney-General's Fraud Control Committee.

3.28 Ten years ago fraud in government was far less of an issue. Nowadays, however, the fear and prevalence of fraud in the public sector increases the need both for more effective systems of internal financial control and for external audit of government moneys.

Change in Audit Technology

3.29 It has never been possible for the Auditor-General to verify every Commonwealth financial transaction. Limitations on resources meant that even at Federation when the Commonwealth Government was small and new, the most common approach to auditing required a sampling of financial transactions. Notwithstanding, some Commonwealth accounts in some portfolios may have been subjected to audit of every receipt and expenditure.

3.30 The external audit function has continued to evolve, particularly in the last decade. This is evident, for instance, in the development of a more systematic approach to estimation of audit risk.

8. Special Minister of State, Review of Systems for Dealing with Fraud on the Commonwealth, AGPS, Canberra, 1987.

3.31 The increasing volume of financial transactions in the Commonwealth sector resulted in the Auditor-General's adoption in the 1970s of a systems-based approach to audit. This meant that external audit became a detailed review of the systems and procedures in major transaction areas, such as revenue, expenditure and payroll. As well, tests of auditees' procedures were performed. Adoption of a systems-based approach led to a reduction in the nature and extent of the traditional audit procedure's focus on individual transactions⁹.

3.32 Application of a systems approach to auditing meant that, other things being equal, audit resources could now be used more effectively. Lately there has been movement away from the systems approach towards a more substantive approach.

Use of Computers and Growth of Financial Data

3.33 Rapid increase in the volume and value of Commonwealth revenue and expenditure has resulted in increasingly heavy reliance by Government organisations on computer storage and manipulation of financial and other data. When auditees' financial systems became computerised, records of transactions ceased to be readily available for direct visual inspection by auditors. Consequently, auditors learned to use computers in their work.

3.34 One dimension of this innovation was that many auditors acquired data processing skills. Another aspect was that audit methodology changed to reflect this new way of storing and accessing financial and related data. For example, the AAO copies auditees' data files and transfers and analyses the files on an AAO mainframe or personal computer. These procedures enable the field auditor to test the auditees' data bases without reliance on reports provided by auditees.

Increased Responsibilities

3.35 Responsibilities of the Audit Office increased in 1979 with the addition of efficiency audits to its mandate. Efficiency audits involve independent evaluation of the efficiency and effectiveness of administrative actions and decisions taken by management in achieving program objectives within the policy guidelines and legislative framework provided by government¹⁰. This new task required the Audit Office to consider non-financial data in appraising the efficiency of administrative units.

9. Cameron, op. cit., p. 17.

10. The Auditor-General, 1986-87 Annual Report, op. cit., p.27.

How Adequate Are Resources for Public Sector Audit?

3.36 There are immense difficulties in answering this question. One approach is to observe whether the Auditor-General had sufficient resources for each of the thousands of audits completed, say, for example, since 1978-79. Each of those audits concluded with an audit opinion. If Auditors-General prepared these knowing that they had insufficient resources to offer an opinion, then they would have acted unprofessionally and irresponsibly. From this case by case or incrementalist perspective, sufficient resources were always available. The perspective used here was to look at changes in the Auditor-General's mandate and resources over a long period.

3.37 The Auditor-General's 1986-87 annual report to Parliament was very candid on the question of resources. The Auditor-General stated that¹¹:

The combined impact of the need to restore adequate audit coverage of departments, the growth of workload and of complexity in the audit of authorities and enterprises, and the attempt to mount a creditable level of performance auditing activity is that the AAO ... is under-resourced.

3.38 Concern over the adequacy of resources was expressed in the AAO submission to this inquiry. The submission stated¹²:

... major changes to the audit mandate ... support the view that the AAO is operating in an environment of a growing workload, due not only to an increase in the number of auditees, but to an increasing complexity of audit work. This, coupled with ongoing resource constraints, indicates that the AAO is not well placed to provide a comprehensive service to Parliament.

3.39 The above changes in growth of government activity, machinery of government, the environment for financial decision-making, audit technology and audit responsibilities have had a profound impact on the Government's external auditor.

11. Ibid.

12. AAO Submission, May 1988, op. cit., p. 61.

TABLE 3.7

Changes in Audit Fees for the 100 Largest Companies Listed on
Australian Stock Exchanges, 1982-86^{1 2}

Year	Audit Fees Per \$1000 of Assets (\$)
1982	0.97
1983	0.93
1984	0.90
1985	0.77
1986	0.65

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1. Craswell A., et al., Who Audits Australia? The University of Sydney, Accounting Research Centre, Sydney, October 1987.
 2. It is important to note that these costs are not necessarily compatible with the costs of AAO audits quoted earlier.

3.40 On the one hand, changes in audit technology have increased audit productivity. However, this has been compensated for by greater expectations of external audit which now operates in a more varied and complex economic and political environment than in the nineteen seventies.

3.41 An assessment is necessary of whether these two factors, increased audit productivity and increased audit workload, in terms of the number and difficulty of audits, negate each other or whether one factor has been more pervasive. Table 3.6 showed that 3 Audit Office staff were available for the audit of each account in 1977-78, and 1.7 staff were available for the same purpose in 1987-88. Therefore, if the same audit coverage were provided in 1987-88 as in 1977-78, there would have been a 43 per cent increase in staff productivity¹³. Such a massive productivity increase was not reflected in Government expenditure on Audit Office salaries since less was spent on salaries in 1987-88 than ten years previously. Notwithstanding, there was evidence to support the conclusion that audit staff were significantly more productive than ten years ago, but the increase would not have been 43 per cent. In comparison, all industry per person productivity growth as measured by the ABS from 1977-78 to 1985-86 increased by 14.2 per cent¹⁴.

3.42 The 43 per cent figure for the Audit Office would have been theoretically a maximum increase. However, some account must be taken of increases in audit workload responsibilities and in the complexity of the audit task. When these additional responsibilities were considered, the 43 per cent increase in staff productivity necessary to maintain, in the late nineteen eighties, the same degree of audit coverage as in the late nineteen seventies was difficult to achieve if it were achieved at all.

3.43 Table 3.7 reveals that between 1982 and 1986, audit fees paid by the 100 largest companies listed on Australian stock exchanges fell from \$0.97 to \$0.65 per \$1000 of assets. Comparable data on the value of Commonwealth assets were not available. Therefore no attempt should be made to compare audit costs for the Commonwealth and for Australia's largest companies because of differences in the measures and data bases. This should be a caution on interpretation of the audit data presented in this Chapter.

3.44 In the case of the Commonwealth's accounts the Committee believes that increases in the audit mandate were

13. This is based on a number of assumptions, such as that the ratio of large to small accounts was constant over the decade.

14. ABS, Australian National Accounts: Gross Product by Industry, Australia, 5211.0, ABS, Canberra, 1988, Table 1.

greater than any increases in staff productivity. If so, then the Commonwealth had more reason to believe in 1977-78 that its accounts were adequately audited than it did in 1987-88.

3.45 A spectre of under-auditing appears at a time when taxpayers are demanding more efficient government, and when fraud in the public sector has accelerated rapidly.

How Has the Australian Audit Office Responded to Changes in Its Workload and Responsibilities?

3.46 The AAO has been required by the growth in numbers of statutory authorities and companies combined with legislative requirements to devote more of its resources to the audit of those organisations. Fifty-six per cent of AAO resources were devoted to financial statement audits of authorities and companies in 1984-85, compared with approximately 67 per cent in 1987-88. There was a corresponding decrease in the amount of audit work in government departments with approximately 9 per cent of AAO resources allocated to financial or regularity audits in government departments in 1987-88¹⁵.

3.47 This is a remarkably low level of resources for the audit of departments, remembering the enormous sums which they are charged with administering. The 9 per cent level of resources may be the nadir since the Government has responded to a PAC recommendation in its guidelines for annual reports¹⁶ and accepted the need, first, for departments to prepare financial statements, and second, to have those financial statements audited¹⁷.

3.48 The AAO has increased resources for financial or regularity audits at the expense of performance audits. Between 1986-87 and 1987-88, resources for regularity audits increased from 72 per cent to 83 per cent, while resources for performance audits fell from 28 to 17 per cent (Table 3.8). When making sense of these figures, it must be remembered that the 1976 report of the Royal Commission on Australian Government Administration recommended that the Auditor-General's jurisdiction be expanded to include efficiency audits¹⁸. 1979 amendments to the Audit Act gave the Auditor-General the authority to conduct efficiency audits, which were an important new kind of performance audit¹⁹.

15. AAO Submission, op cit., p.73.

16. Joint Committee of Public Accounts, Guidelines for Annual Reports, Report 262, AGPS, Canberra, 1986.

17. Audit Act 1901, section 50.

18. RCAGA. op.cit., p.375.

19. Audit Act 1901, Division 3, section 48A-48H.

TABLE 3.8

Percentage Allocation of AAO Resources¹

Type of Audit	Percentage of Resources	
	1986-87	1987-88
Regularity audits		
. Financial statements	59	66
. Government accounting	8	10
. Other	5	7
. Subtotal	72	83
Performance audits		
. Efficiency	7	6
. Project	21	11
. Subtotal	28	17
Total	100	100

1. AAO Submission, op. cit., pp.62-63: The Auditor-General, Annual Report 1987-88, op.cit., p. 21.

In the debate on the Audit Amendment Bill, Government and Opposition concurred that introduction of efficiency audits to the Auditor-General's responsibilities was a highly significant innovation in Commonwealth administration²⁰. Neither the potential nor actual importance of efficiency audits is reflected in the resources the Audit Office has allocated to this task in recent years.

3.49 Efficiency audits are conducted at the Auditor-General's discretion. Faced with increases in the amount of mandated financial and regularity audits, Auditors-General have had no choice but to withdraw resources from performance audits in order to conduct mandated audits. Reduction in the attention given to efficiency audits was a matter of serious concern to the previous Auditor-General, who said in his 1986-87 Annual Report that²¹:

The future of the AAO's performance auditing function is clouded by the question mark that hangs over the adequacy of its resource provision.

3.50 This is highlighted by how, given that the AAO has identified more than 121 programs each having a value in excess of \$100m, and a further 229 programs with an annual value between \$10m. and \$100m, it would take more than 40 years to subject even one part of each of these programs to a full efficiency audit²².

3.51 This 40 year cycle of efficiency audits ignores any need for efficiency audits of the 476 program with expenditure of less than \$10m. Consequently, efficiency audits have a far more limited role in improving the Commonwealth sector's economy, efficiency and effectiveness than originally conceived.

3.52 When all of these factors are considered, the adequacy of the Commonwealth's expenditure on financial or regularity audits causes concern, while the inadequacy of resources for efficiency audits is beyond doubt.

20. House of Representatives, Hansard, 12 September 1978, p. 824, 25 October 1978, p. 2295, 14 November 1978, p. 2740.

21. The Auditor-General, Annual Report 1986-87, op. cit., p. 11.

22. C Monaghan to Secretary, JPCPA, 13 December 1988.

Chapter 4

AUDIT COSTS

4.1 This Chapter presents factual information on audit costs, including information on audit fees. The data are presented to develop greater awareness of how the AAO uses its resources and the origins of its resources.

4.2 Audits are paid for in two ways:

- by the Commonwealth Government through its annual appropriation to the AAO in the Budget. Virtually all Audit Office resources come from its annual appropriation; and

- by those auditees required by the Minister for Finance to pay audit fees. An amount equivalent to one third of the appropriation is paid by auditees through the AAO into the Consolidated Revenue Fund as audit fees.

Audit Costs

4.3 Table 4.1 records the resources allocated to different kinds of audits by the AAO in 1987-88. These data should be considered alongside Table 3.2 which shows the number of different types of audits of different kinds of government organisations. Table 4.1 shows that in 1987-88:

\$10.9m was allocated to financial statement audits and the audits of accounts and records;

\$3.0m was allocated to project audits; and

\$1.0m was allocated to efficiency audits.

4.4 These figures excludes travel, accommodation and computer costs and many central administration costs¹.

1. Additional information is in Auditor-General, Annual Report 1987-88, op. cit., p.89.

TABLE 4.1

Resources Allocated by the AAO to the Audit of Commonwealth Government Organisations 1987-88¹ 2

Type of Commonwealth Government Organisation	Accounts and Records ³ \$	Financial Statements ³ \$	Project Audits \$	Efficiency Audits \$	Total \$
Departments and Outriders	2,260,055		2,482,882	767,666	5,510,603
Departmental Commercial Undertakings	1,007,285		15,485	0	1,022,770
Statutory Authorities	6,377,041		515,186	240,926	7,133,153
Companies	1,226,350		50,116	0	1,276,466
Total	10,870,731		3,063,669	1,008,592	14,942,992

1. The Auditor-General, Annual Report 1987-88, op.cit.
2. Resources allocated to various types of audits by organisation type excludes corporate management costs such as travel, accommodation and information technology.
3. Data were not available to show expenditure on these different kinds of audits or audit reports.

4.5 Other patterns evident in Table 4.1 were as follows. In terms of kinds of audits:

most resources were devoted to regularity audits of statutory authorities (\$6.4m); and

the least resources were for project audits of departmental commercial undertakings (\$15,585).

4.6 Data were not available to determine what proportions of project audit expenditure were for regularity or performance audits. Setting project audits to one side:

expenditure on regularity audits was ten times as much as on performance audits (\$10.0m vs \$1.0m).

4.7 When type of Commonwealth Government organisation was considered:

\$7.1m was spent on audits of statutory authorities;

\$5.5m was spent on audits of departments and outriders;

\$1.3m was allocated to audits of government companies; and

\$1.0m, the smallest expenditure, was on the audit of departmental commercial undertakings;

4.8 Table 4.2 shows the average costs of different kinds of audits by type of government organisation. The Table indicates that:

the average cost of regularity audits was \$30 030;

the average cost of project audits was \$16 926; and

the average cost of efficiency audits was \$126 074.

4.9 Clearly, efficiency audits were the most expensive audits. The Table also shows that:

regularity audits of departments and outriders had the highest average cost of \$2.3m. This was

TABLE 4.2
Average Costs of AAO Audits of Commonwealth Government Organisations in 1987-88

Type of Commonwealth Government Organisation	Accounts and Records ¹ \$	Financial Statements ¹ \$	Project Audits ² \$	Efficiency Audits \$
Departments and Outriders	2 260 055	-	-	127 944
Departmental Commercial Undertakings	34 734	-	-	0
Statutory Authorities	30 080	-	-	120 463
Companies	10 220	-	-	0
Total	30 030	16 926		126 074

1. Data were not available to show expenditure on these different kinds of audits or audit reports.
2. Information on the number of project audits of different kinds of Commonwealth organisations was not available to permit calculations of average costs of project audits.

because this audit was of financial statements prepared by the Minister for Finance, which included the financial statements of all departments;

regularity audits of companies were the least costly of all kinds of audits at \$10 220 each; and

there was little variation in the average cost of efficiency audits of departments and statutory authorities, (\$127 944 vs \$120 463).

4.10 The Audit Office took a considerable amount of time to produce these average costs because the Office's records are in terms of hours spent on each audit rather than actual expenditure. These average costs excluded oncosts such as staff leave, furlough, travel and office expenditure. Consequently, the figures reported here are not an accurate reflection of actual costs. This matter will be discussed further later in this Chapter.

Who Pays Audit Fees?

4.11 Section 63Q of the Act gives the Minister for Finance the authority to identify bodies which should pay fees to the Auditor-General. These bodies are substantially self-funding and are identified in Appendix 5.

4.12 Fees are charged only for regularity audits. Fees for efficiency audits were eliminated in 1987 on the advice of a 1983 Interdepartmental Committee on efficiency audits. It was argued by the Committee that it was inappropriate for fees to be charged since such audits were not performed at the request of the body audited nor were those bodies able to determine the scope of audits².

4.13 Table 4.3 shows that:

Approximately one third of the Audit Office's auditees, (97 of 315) paid fees in 1987³. The Auditor-General does not charge fees for two-thirds of his work;

fees compromised \$8.3m or approximately one third of the \$25.0m total outlays in 1987-88; and

2. The Parliament of the Commonwealth of Australia, Senate, Statute Law (Miscellaneous Provisions) Bill 1987. Explanatory Memorandum (circulated by authority of the Attorney-General, the Hon Lionel Bowen, MP), 1987.

3. C Monaghan to Secretary, JPCPA, 11 August 1988.

TABLE 4.3

AAO Fees and Total AAO Expenditure, Selected Years.^{1 2}

Year	AAO Fees (\$'m.)	AAO Expenditure (\$'m.)	Percentage %
67-68	1.6	14.3	11.5
72-73	1.6	20.5	7.7
77-78	5.6	23.1	24.3
78-79	4.6	22.9	20.3
79-80	5.0	23.1	21.7
80-81	5.8	24.8	23.3
81-82	7.4	26.5	27.7
82-83	7.6	24.1	31.6
83-84	5.8	24.7	23.5
84-85	9.3	24.8	37.6
85-86	7.8	26.1	29.9
86-87	7.9	25.8	30.6
87-88 ³	8.3	25.0	33.2

1. AAO Submission, op. cit., p. 355.

2. All dollars are expressed in average 1987-88 values.

3. Estimates only.

fees as a proportion of expenditure are approximately three times as much as twenty years ago. There has been some variation in the proportion of fees to expenditure in the last ten years.

How Much are Audit Fees?

4.14 In 1986-87:

fees for 30 auditees were between \$1 and \$10 000;

fees for 38 auditees were between \$10 001 and \$20 000;

fees for 15 auditees were between \$50 001 and \$100 000; and

fees for 14 auditees were greater than \$100 001, including fees for one organisation which were greater than \$1m or nearly 20 per cent of total fee revenue.

4.15 The Auditor-General determines the scale of audit fees in a manner approved by the Minister for Finance (section 63Q). This formula includes the direct cost of salaries for actual time spent on the audit of a particular client; an overhead loading to cover leave, furlough, travel and subsistence costs, office overheads and other indirect costs; and a loading for training and other non-productive items. Average fees are much higher than average costs because of inclusion of these items in the calculation of average fees. The average audit fee in 1987-88 for the audit of companies was \$20 398 compared with the average cost of \$10 220 (Table 4.2). Clearly, average costs do not reflect actual costs.

4.16 The Committee recommends that:

- . In future, the Australian Audit Office calculate the average costs of all audits, and that calculations should be based on the formula used to estimate audit fees.

4.17 Total costs of each audit are determined by the Auditor-General. Neither the client (the Parliament) nor auditees have any direct influence over fees charged for audits. As

mentioned earlier, the Auditor-General does not retain any income from fees. Rather, the latter are paid by auditees to the AAO, which deposits them in the Consolidated Revenue Fund. This notional fee income is considered when the Department of Finance advises the Government on the AAO's annual appropriation.

4.18 Information on the base or hourly rate of fees charged by the larger private accounting firms and partnerships is difficult to obtain. However, the March 1988 Chartac survey gave an indication⁴. Table 4.4 compares data from the Chartac survey with data from the AAO, and reveals that the latter's hourly rate for the services of different levels of personnel was less than the hourly rate for small to medium city firms. A caveat is that there would be much variation in fees charged by private firms. Regrettably, no data were available to compare AAO staff charge rates with those of the largest accounting firms. Bigger differences in fees set by the Audit office and the largest accounting firms would have been observable. On average the AAO charged approximately \$60 per hour for audits while it is believed that a typical large accounting firm would charge approximately \$85-90 per hour for audits.

4.19 Few data were available to compare the total costs of audits executed by the 'Big 8' and the AAO. Evidence available to the Committee pointed towards the AAO charging substantially less for major audits than private audit firms. However, (at time of writing) the only example of where the AAO had submitted a tender in competition with large private audit firms suggested that AAO's total charges were similar to those of the private sector.

4.20 No comparative evidence was available on the relative efficiency of audits conducted by the Audit Office and large private firms. Nor was substantive comparative information available on any differences in the focus, scope, methodology and duration of audits. These are further matters for research. In other words, further analysis is necessary of the way in which the Audit Office conducts its audits to determine if costs can be reduced to generate efficiency gains.

4.21 The Committee recommends that:

- . The Independent Auditor of the Australian Audit Office analyse the way in which the Australian Audit Office conducts its audits to determine if costs can be reduced to generate efficiency gains (see Chapter 16).

4. Chartac Accounting Report, March 1988, No. 126.

TABLE 4.4

Comparison of AAO Hourly Fee Rate with the Hourly Fee Rate for
Small and Medium City-Based Accounting Firms^{1 2}

<u>AAO</u>		<u>Big 8</u>	
Classification	Hourly Fee Rate	Classification	Hourly Fee Rate
First Assistant Secretary 3	-		
SES Level 2	93	Partner/Principal	140
SES Level 1	85		
ASO8/CSO4	72	Manager ⁴	109
ASO7/CSO3	63	Supervisor ⁵	75
ASO6/CSO2	58	Senior ⁶	70

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1. C Monaghan to Secretary, JPCPA, 24 June 1988.
 2. Data were not available to permit comparison of fees charges by the audit divisions of large accounting firms with AAO fees.
 3. There are no charge rates for AAO First Assistant Secretaries.
 4. Manager: Qualified with at least seven years experience. Responsible for control, scheduling and review of jobs; controls client servicing including internal office work flow; advises on budgeting and billing, develops and allocates staff.
 5. Supervisor: Qualified with about five years experience. Controls specific consignments directly, reporting to a manager or partner; reviews work of subordinates, controls time budgets, liaises with client, trains and develops junior staff.
 6. Senior: Qualified with three years experience. Controls individual jobs reporting to a supervisor or manager; controls staff on the job; develops junior staff; some client liaison.

Fee Problems

4.22 Some auditees complained about the Auditor-General's fees on the following grounds. They argued that they had no control over:

the base rate of audit fees which was determined by the Auditor-General; and

the total audit fee which was set by the Auditor-General.

4.23 Objections of many auditees to audit fees became obvious shortly after passage of the 1979 amendments⁵. For instance, in 1981 and 1982 the Auditor-General identified the tendency of auditees to take the view that payment of a fee entitled them to influence the scope of proposed audits, the manpower to be employed and overall costs⁶.

4.24 While the Committee has heard the views of some auditees that on occasion the Auditor-General's fees may have been unnecessarily high, (implying inefficiency), the major objections of many auditees to the Auditor-General's total fees are based, first, on a lack of knowledge of who determines the base rate chargeable for audits, and second, on the mistaken idea that they - the auditees - are his clients. Government organisations sometimes prefer private sector audit firms because of the other services these can make available to clients.

4.25 The Committee believes that there is no acceptable alternative to the external auditor's determination of the audit's focus or scope. The latter is a function of the auditor's judgement on the work he believes necessary to be able to attest to the truth and fairness of financial statements. Certainly the focus should not be determined by the auditee.

4.26 Hours charged to an audit can reflect the condition of the auditees' accounts, records and financial statements. Audit fees will be higher if these are not in good condition.

5. C Monaghan to Secretary, JPCPA, 24 June 1988.

6. Auditor-General, Report of the Auditor-General upon the Financial Statements Prepared by the Minister for Finance for the Year ended 30 June 1981, AGPS, Canberra, 1981; Auditor-General, Report of the Auditor-General upon the Financial Statements Prepared by the Minister for Finance for the Year ended 30 June 1982, AGPS, Canberra 1982.

4.27 The Auditor-General is obliged to conduct his work efficiently and should not seek to do unnecessary audits. However, the fact that he has so many auditees and so few resources reduces the likelihood of unnecessarily lengthy and costly audits, although these can occur.

4.28 The AAO's legislation permits it to monopolise certain audit markets. Yet there are constraints on its audit charges, including:

the Minister for Finance's approval of the manner in which the AAO determines its hourly rate of fees;

the legislative right of many important auditees, such as statutory marketing authorities in the Primary Industries and Energy Portfolio and government business enterprises in the Transport and Communications Portfolio to advise on appointment of an external auditor who may not be the Auditor-General;

the necessity of not stimulating other auditees to approach the Government to permit them to select their own external auditor in preference to the Auditor-General;

the prohibition on the Audit Office retaining fees or making a profit from fees, (section 63Q of the Audit Act).

4.29 The last point is a major departure from private sector practices, since fees charged by private audit firms are received by the latter. In other words, the Audit Office does not benefit directly from fees. (ii) and (iii) above refer to the constraint of fear of loss of auditees. This fear when combined with DOF control of the manner in which the basic rate is set is a powerful set of constraints on total fees charged in the AAO's monopoly areas.

4.30 The AAO is not permitted to make a profit from its fees. Notwithstanding, the implications of the AAO being permitted to make a profit from fees are worth exploring. Any notional profit from fees could be used to subsidise costs in the non-fee area. In other words, any inadequacy in the level of Parliamentary appropriations could be alleviated by extra revenue from statutory authorities involved in commercial activities. In theory two kinds of potential cross-subsidies are conceivable:

subsidisation of regularity audits of departments and their outliers by fee-paying audits of statutory authorities involved in commercial activities and by audits of incorporated companies; and

subsidisation of performance audits, for which no fees are charged, by 'user-pays' regularity audits.

4.31 Neither option is available to the Audit Office.

4.32 It is very important for information about public sector audit fees to be in the public domain, just as information on audit fees for private sector companies is available from the annual reports of companies listed on Australian stock exchanges. The Government agrees with this approach since the DOF's guidelines to Commonwealth undertakings require disclosure of external audit fees⁷.

4.33 It is equally important for information on the costs of audits for which fees are not charged to be published. It will be remembered that fees are not charged for two-thirds of the Audit Office's work. At present, the costs of efficiency audits are included in the Auditor-General's annual report to Parliament. There are very few data publicly available on the costs of other audits which comprise the bulk of the Auditor-General's work. This situation must change because, with rapid growth in the number of AAO audits due to the requirement to audit the financial statements of government departments and associated agencies from the 1988-89 financial year, there will be greater awareness from interested parties of audit costs and the efficient use of audit resources.

4.34 Audit costs and the user pays principle are explored further in Chapter 5.

7. Department of Finance, Guidelines for the Form and Standard of Financial Statements of Commonwealth Undertakings, DOF, Canberra, July 1987.