

**PART B**  
**MAJOR CHANGES**

## Chapter 5

### INDEPENDENCE AND ACCOUNTABILITY

5.1 It is meaningful to discuss the independence of the Australian Audit Office in terms of the independence of the Auditor-General. The independence of the Auditor-General arises from the legislative basis in Part II of the Audit Act 1901 for the creation of the position.

5.2 The status and importance of the role is suggested by the method of appointment, which is made by the Governor-General on the advice of the Prime Minister, (section 3). The Auditor-General cannot be a member of the Executive Council of the Commonwealth or any State or a member of any House of Parliament. The appointment is until the incumbent reaches the age of sixty-five years. He can be removed from office in two ways, as follows, (section 7)<sup>1</sup>:

simultaneous requests from both Houses of Parliament; and

suspension by the Governor-General for incompetence or misbehaviour on the advice of the appropriate minister.

5.3 The Auditor-General has the authority to appoint staff to inspect, examine and audit any accounts, records or stores required by the Audit Act 1901, (section 11). This provision enables the Auditor-General to create an Office for the exercise of his duties. It is his responsibility to draw to the attention of the appropriate minister such matters arising from the exercise of his powers which he deems sufficiently important. Where the matter involves an efficiency audit, he must also draw the matter to the attention of the Prime Minister and the minister administering the department where the audit is conducted, (section 12).

5.4 His powers are extensive, in that he may request persons to appear before him and to produce all accounts and records necessary for an audit, (section 13). Also, he may search

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1. References in the text to sections refer to sections of the Audit Act 1901.

and take extracts from any records in the custody of a Minister or in any public office. He or his staff is entitled to have access to all accounts and records of receipt or expenditure of public moneys, (section 14).

5.5 The Auditor-General determines the nature and scope of audit activity appropriate for the exercise of his responsibilities. In other words, he determines audit standards, methodologies, and the extent of audit coverage necessary to form an opinion.

5.6 The Auditor-General has the authority of a secretary of a government department under the Public Service Act in relation to staff appointments. Also, as in government departments, the Department of Industrial Relations and the Public Service Commission exercise statutory functions in personnel management in the AAO, including setting of terms and conditions of employment and salaries.

5.7 Another important similarity with government departments is that the AAO's annual resource estimates are scrutinised and negotiated with the Department of Finance. The AAO's estimates are included with those of the Minister for Finance's portfolio. For administrative purposes other than budgetary arrangements the AAO is attached to the Prime Minister's portfolio. The Prime Minister's department is responsible for administering sections 3-9A of the Audit Act relating to the Auditor-General's appointment.

5.8 The Auditor-General reports to Parliament on his audit of the receipt and expenditure of public moneys by the executive arm of government. He audits government moneys according to legislation and regulations determined by Parliament which is his client. Government departments and other bodies which he audits, and which are called auditees, are not his clients.

5.9 In order that the Auditor-General's audits and reports be accepted as valid, it is essential that the Auditor-General should not be subject nor be suspected of being subject to pressure from the executive or legislative arms of government to report in one way or another. In other words, his independence is fundamental to the objectivity of his judgements and acceptance of the latter. Without statutory independence there could be doubts over whether he impartially exercised his functions.

## International Views on Independence

5.10 Concerning the independence of the national audit office, the International Organisation of Supreme Audit Institutions, INTOSAI, argued that<sup>2</sup>:

complete independence is neither possible nor desirable, but an adequate degree of independence from the legislature and executive is essential for conduct of the audit and to the latter's credibility;

independence from political influence is essential for impartial audits. The national audit office should not be responsive to particular political interests;

the national audit office must be free to set its own audit priorities and methodologies;

the legislature can set minimum reporting requirements, but the national audit office should have much discretion on the content and timing of reports;

the national audit office assists the executive by drawing attention to deficiencies in administration and recommending improvements; and

maintenance of the auditor's independence does not preclude the executive from requesting particular audits.

5.11 The United Nations stated the following in regard to independence of the national audit office<sup>3</sup>:

independence is the most crucially important auditing standard;

audit objectivity is not possible without independence;

government is an interested party in auditing. Therefore, there are incentives for biases in presentation of information;

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2. INTOSAI Auditing Standards, 3 June 1987.

3. United Nations, Audit Standards in the Public Sector. An Analysis of Comparative Experience, United Nations, New York, 1987.

independence of the auditor is maintained by recourse to auditing standards and to a code of professional ethics; and

ultimately, the auditor's independence depends on the environment for accountability.

## Local Views: 1901

5.12 Concern over the question of resources necessary for the Auditor-General to properly exercise his statutory independence has been an enduring theme since Federation. Initially in 1901, 16 staff were appointed to the Auditor-General's Office. However, these were insufficient to cover his audit mandate as the Auditor-General wrote in 1902 in his first annual report to Parliament<sup>4</sup>:

Every effort has been made to prevent the ordinary routine work of the office from falling into arrears, the whole of the staff at various times working overtime, a portion until very late hours; but the pressure is too great for the present strength to overcome, and to my great concern, I find that the provisions of the Audit Act cannot be strictly complied with, .... and the important duty of local inspection cannot be performed as fully as is deserved.

I am grateful to the Right Honourable the Treasurer for the assistance he has always given to me when it was applied for, four of the clerks already referred to having been added to the staff in September last, .... and several temporary assistants have now been engaged for some time to help to bring the work up to date; but the office was not fully equipped for the duties it had to perform, and a further addition to the staff has been found necessary. No proper allowance is at present made for emergencies, such as absences through illness or for leave granted for recreation.

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4. Auditor-General, Report of the Auditor-General for the Commonwealth upon the Treasurer's Statement of Receipts and Expenditure During the Year Ended 30th June 1902. The First Annual Report of the Auditor-General under the Audit Act 1901, Government Printer for the State of Victoria, Melbourne, 1902, p.128.

5.13 Of note in the Auditor-General's first annual report was his acknowledgement of the staffing assistance provided by the Treasury. Provision of advice to Government on staffing matters is now the responsibility of the Department of Finance (DOF).

## 1987 and 1988

5.14 The Auditor-General's 1986-87 Annual Report commented on the relationship between resources for the Auditor-General's Office and the latter's independence<sup>5</sup>. He stated that there was no recent experience of Ministerial interference in the Auditor-General's exercise of his audit mandate. This laid to rest any unease about political interference in audits. However, there were other restrictions on his independence since:

there persists a sensitive question of whether indirect influence can be exerted on the independence of the audit function through pressure on resources.

5.15 The International Organisation of Supreme Audit Institutions Auditing Standards were quoted approvingly, as follows:

...effective promotion of public accountability requires that the Supreme Audit Institution, SAI, be provided with sufficient resources to enable it to discharge its responsibilities in a reasonable manner.

Any imposition of resource or other restrictions by the executive which would constrain the SAI's exercise of its mandate would be an appropriate matter for report by the SAI to the legislative.

5.16 He then described negotiations between his Office and the Department of Finance concerning the Audit Office's annual appropriation. Outcomes of these negotiations were described as reasonable. He was most critical, however, of the tenor of those negotiations wherein, were the AAO to seek additional resources, the Department stated that it would use its powers to initiate a 'comprehensive review' covering the impact on the AAO's workloads of various projected administrative changes. The Auditor-General described such an eventuality as a challenge to his statutory responsibility to determine the manner in which the audit function was exercised.

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5. The Auditor-General, Annual Report 1986-87, op. cit., Chapter 1.

5.17 The Auditor-General's concerns were sufficiently serious for the Public Accounts Committee to address them in this inquiry. The underlying question is whether resource reductions compromise the Auditor-General's independence.

## Independence Reconsidered

5.18 The Auditor-General's independence is exercised in a number of ways through decisions on:

which audits will be conducted;

the types of audits to be conducted; and

how many audits are necessary.

5.19 Common views of threats to the Auditor-General's independence deal with restrictions on which organisations, activities or programs he believes should be audited. It needs to be stated clearly that, according to the AAO, there are no instances in living memory where a minister has interfered with audits<sup>6</sup>. Generally speaking, resource restrictions have no impact on this kind of decision. Nevertheless, resource restrictions can determine the types of audits initiated. We have seen how the Audit Act requires the Auditor-General to conduct regularity (including financial) audits while performance audits are at his discretion.

5.20 Statements quoted earlier from the Auditor-General expressed his frustration at not being able to conduct more performance audits and his consternation at the future of performance audits. Decisions on overall resources compelled him to reallocate resources from discretionary performance audits to mandated regularity audits.

5.21 The final domain of the Auditor-General's role considered here is his judgement on the number of audits necessary for him to fulfil his charter. Statistics quoted earlier highlighted the reduction in the Audit Office' resources relative to the size and nature of the task. Those statistics demonstrated that there was reason to be concerned about the level of audit coverage in the Commonwealth sector. Clearly, in this domain, resource shortages diminish the Auditor-General's capacity to conduct the number and extent of audits he thinks fit.

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6. AAO Submission, op. cit.

## Models of Resource Allocation

5.22 The amount of resources for public sector audit is partly a function of the mechanisms adopted to determine resources. With this in mind, three models of resource allocation to national audit offices in three different countries are examined<sup>7</sup>. These are as follows:

the audit office determines its own resources, Canada, or the audit office charges fees;

the executive determines the audit office's resources, Australia;

Parliament determines the audit office's resources, United Kingdom.

### Audit Office Determines Its Resources

5.23 There are two ways in which this can occur, as follows:

by a national audit office recommending its own resource level to Parliament; and

by a national audit office setting and charging fees.

### A National Audit Office Recommends Its Own Resources

5.24 The Office of the Auditor-General of Canada develops its own expenditure estimates and proposes its own annual budget. The executive arm of government has no role in assessing the proposed budget. The equivalent of the Australian Department of Finance develops the financial legislation, which is tabled in Parliament by the Minister for Finance<sup>8</sup>. Parliament votes on the latter with an oversight contribution to the debate by the Public Accounts Committee<sup>9</sup>.

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7. Appointment of auditors in the private sector is described in Appendix 6.
  8. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 26 October 1988, pp. 1651, 1164, 1683.
  9. Office of the Auditor-General of Canada, 1988-89 Estimates, Part III, Expenditure Plan, Minister of Supply and Services, Ottawa, 1988.

5.25 This model is attractive because of the pure independence of the Auditor-General on resources issues. However, this is also the model's weaknesses since, for practical purposes, Parliament, plays little role in the setting of resource levels.

#### A National Audit Office Sets and Charges Fees

5.26 A national audit office which set and charged its own fees would determine its own resources. Neither in Canada, Great Britain, New Zealand nor in the United States did the national audit office exist only on income from fees. A common pattern was for total resources to come from a combination of government appropriations and fees. This combination also occurs in several Australian States.

5.27 Fee-charging focus attention on audit costs. Fee-charging in a competitive environment may result in more efficient utilisation of audit resources and perhaps encourage innovation in audit techniques. Therefore, there are sound reasons for audit fees to be used as a discipline on the auditor.

5.28 The disadvantage is that when fees are charged in the Commonwealth sector in Australia, the client does not pay fees but the auditee does. Thus, for example, the CSIRO pays fees and not the Parliament. This practice of the auditee rather than the client paying fees has promoted confusion amongst auditees since their payment of the AAO is consistent with the auditee being the client. No matter that an auditee knows that, technically speaking, this is incorrect. The lack of congruence between the principle of the auditor working for Parliament yet being paid by the auditee continues to promote the misguided expectation that the auditor is working for the auditee. Also, as evidence given to the Committee testified, the practice promoted tension between the Commonwealth auditor and the auditee<sup>10</sup>.

5.29 Commercially-oriented government organisations which pay audit fees to the Auditor-General are anxious to reduce audit costs as much as possible. Hence, it is almost inevitable that they compare their audit fees with those of their competitors and, if the latter's audit fees are less than theirs, seek to have the Auditor-General removed as their external auditor. Their competitors have some influence over audit fees while they do not. Also, it is very common for commercially-oriented government organisations to note that their competitors' auditors, which are usually the largest audit firms, provide non-audit services. The AAO has not provided these in the past. Therefore, it can appear to these government organisations that they are not receiving value for money from the AAO.

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

5.30 There is already a gap in expectations between many auditees and the AAO because of the Government's expectation that certain kinds of statutory authorities and government companies should be more responsive to the market place, while simultaneously these organisations are expected by the Government to follow the financial management code determined by the Audit Act. These organisations are pressured by both market forces and the Government's auditor. These forces need not push in the same direction.

5.31 One way out of this bind would be for the auditee to pay the AAO for the attest function and for Parliament to pay the AAO for the accountability function. This approach has been adopted in New Zealand. The Committee does not favour this approach for Australia because, even if the costs of the Auditor-General exercising his accountability function were readily identifiable (and there are many practical problems in such identification) for the auditee to continue to pay any audit fee still maintains the confusion over who is the Auditor-General's client.

5.32 Where the Auditor-General charges fees and auditees are not permitted to select their external auditor, fees are a weak incentive to efficient resource allocation by the Auditor-General. Where the Auditor-General charges fees to those auditees which can choose their external auditor, the Auditor-General may be inhibited in his work for fear of losing prestigious auditees. Other kinds of mechanisms are available to maintain pressure on the Auditor-General to use resources efficiently.

5.33 The fundamental problem is whether maintenance of a centralised approach to determination of the AAO's resources on an annual basis is compatible with the AAO charging fees for its services. After careful consideration of this matter, the Committee has determined that they are not compatible. Parliament wishes to maintain control of public sector expenditure which it does through the appropriations acts. Once it determines an appropriation for the AAO, Parliament, in some respects, has set a limit on how much auditing it wants. Clearly, bargaining has always occurred and will continue to take place between the Auditor-General and Government and Parliament on this matter. Movement to a system wherein the Auditor-General funded all audits through fees would mean that the Auditor-General had greater authority to determine how much auditing was necessary, and Parliament would have less control over this area of expenditure. There is no sign that Parliament is willing to give him increased authority on this matter. What is envisaged is that negotiations over how many resources were necessary would have a different basis than at present, (see later).

5.34 The Committee recommends that:

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

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<sup>11</sup>.

Auditees record audit costs in the notes to their financial statements.

#### Executive Determines Audit Office Resources

5.35 In Australia the Department of Finance advises the Minister for Finance on the AAO's proposed budget. A feature of this approach is its consistency whereby the Department applies to the Audit Office the same approaches to resource questions it uses with other Budget-dependent agencies. No special treatment or privileges are offered to the Audit Office nor is it specially disadvantaged. The Department of Finance submission argued that it should remain the Executive's principal advisor on the AAO's resources, but that it should recognise the special position of the Auditor-General<sup>12</sup>.

5.36 It is worth recounting the recent history of resource allocation to the AAO. The 1979 amendments to the Audit Act gave the AAO responsibility for efficiency audits, which was a substantial increase in the AAO's responsibilities. In December 1983 the Government accepted that efficiency audits should remain with the Audit Office and not be moved to another agency. Prior to that, the adequacy of resources for efficiency audits had been a matter of disagreement between the Auditor-General and the executive, namely with the Department of Finance. In the early part of the decade, another matter on which the Auditor-General disagreed with an executive arm of government, which this time was the Public Service Board, was in regard to classifications of SES positions. Those classifications were beneath those of other central agencies, such as the Department of Prime Minister and

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11. An Earlier PAC report made a similar recommendation. JPCPA, Review of Efficiency Audit - Administration of Capital Grants to Non-Government Schools, 288th Report, AGPS, Canberra, 1987.

12. Department of Finance Submission, June 1988.

Cabinet, Public Service Board and the Department of Finance<sup>13</sup>.

5.37 This lag in staff classifications hindered recruitment and exchange of senior staff. In the Auditor-General's opinion, these decisions of executive government restricted execution of the audit task affecting both the number of audits, particularly efficiency audits, and audit quality. Difficulties associated with control of his Office by the executive led the Auditor-General to pose the question<sup>14</sup>:

It is timely to question whether the independence of the Auditor-General and the Australian Audit Office from the executive arm of government is not more apparent than real.

5.38 The Australian Audit Office's annual appropriation was determined as part of the appropriations for the Department of Prime Minister and Cabinet. It was suggested by the Auditor-General that the AAO should be segregated from other elements of the Prime Minister's portfolio in the budgetary process and in the presentation of Appropriation Bills and Budget documents<sup>15</sup>. The idea was to avoid a trade-off between the Auditor-General's Office and executive government areas of the Prime Minister's portfolio. Consequently, for the 1986-87 year onwards, the AAO's annual estimates were included in the Minister for Finance's portfolio.

5.39 The Auditor-General's high hopes for the effects on his resources of this change of location were not realised. In fact, disagreement between the Department of Finance and the Audit Office on resources issues was so intense the Auditor-General wrote about it in very strong terms in his 1986-87 annual report. As mentioned earlier, the debate spilled over into the political arena with public statements by the Prime Minister, Minister for Finance, and Leader of the Opposition.

5.40 The level of intensity in the debate fell during 1987-88 partly because the Audit Office was without a permanent chief for many months with a new Auditor-General appointed only at the end of the financial year. Clearly, though, problems in determination of audit resources which existed when the Audit Office's appropriations were settled under the Prime Minister's Portfolio were not resolved by movement to the Minister for Finance's Portfolio.

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13. Auditor-General, Report of the Auditor-General upon the Financial Statements prepared by the Minister for Finance for the Year ended 30 June 1984, section 5, AGPS, Canberra, 1984.

14. Ibid.

15. The Auditor-General, Annual Report of the Australian Audit Office, 1984-85, AGPS, Canberra, 1985.

5.41 Conflict between the Department of Finance, DOF, and Budget-dependent agencies is a normal part of the Budget process. Therefore, there was no reason to be surprised that the DOF and the AAO disagreed over an extended period. What, then, was the difference between the DOF disagreeing with the AAO over the latter's resources and the DOF disagreeing with other agencies over their resources?

5.42 The difference was because the AAO is the only Commonwealth agency to submit the DOF's own internal processes to scrutiny. The Human Rights Commission, the Commonwealth Ombudsman, and the Merit Protection Review Agency are examples of other instrumentalities which have the discretion to examine the DOF's administration of certain matters such as discrimination in recruitment. However, the Auditor-General is the only person with the authority to examine the efficiency and effectiveness of the DOF's management of its own organisational objectives. As mentioned previously, in Chapter 4, audit of the financial statements of the Minister for Finance's financial statements, prepared by the DOF, is the largest single audit for which the AAO is responsible.

5.43 The contradiction in these arrangements is that the Audit Office's most important auditee advises Government on how many resources the Audit Office receives. The nature of this relationship must have a bearing on audits of the DOF. Of note is that Auditors-General tend to make mild statements in their reports on financial statements prepared by the Minister for Finance. Also of note is that no Auditor-General has ever subjected any part of the Department of Finance to an efficiency audit.

5.44 The Committee shares a concern expressed by others that the focus of the Audit Office's efficiency audits has not always been central to improving the economy of Government operations nor Government's efficiency and effectiveness: for example, central departments, such as the Department of Prime Minister and Cabinet, Treasury, and the Department of Finance have never had efficiency audits. In particular, the Committee is very critical of the fact that no part of the operation of the Department of Finance has ever been subjected to an efficiency audit, despite the centrality of the DOF to the Government's operations and the potentially very large savings to Government and improved public sector effectiveness which could accrue from systematic study of the DOF's operations - particularly in the Budget context.

5.45 However, the Committee also acknowledges that there would be an unacceptable strain on the Audit Office if it subjected the organisation which recommends its budget to intensive and prolonged scrutiny. For this reason, it is wrong in principle for the Department of Finance to continue to have the final powers of advice on the Australian Audit Office's forward estimates.

final powers of advice on the Australian Audit Office's forward estimates.

5.46 It is noteworthy that the Public Accounts Committee in the United Kingdom reached a parallel conclusion when it stated that<sup>16</sup>:

however independent of Government (the) Exchequer and Audit Department may consider its audit functions to be the Department cannot be truly independent of the executive if its number and gradings are controlled by the Civil Service Department.

It is constitutionally anomalous for control over the budget and staffing of (the) Exchequer and Audit Department to rest with the executive. The best that can be said for the present administrative arrangements is that they work. But there might well be dangers for parliamentary accountability in the present very close relationship between (the) Exchequer and Audit Department and, more particularly, the Comptroller and Auditor-General and the executive.

#### Parliament Determines Audit Office Resources

5.47 The final model of resource determination for a national audit office gives Parliament this responsibility directly. The advantages of this arrangement are twofold, as follows:

to avoid the conflict in the previous model whereby the Government sets the Audit Office's resource levels based on the advice of the Audit Office's most important auditee; and

to strengthen the Auditor-General's accountability to Parliament.

5.48 Despite the Commonwealth Parliament being the Auditor-General's client, historically, the Parliament has taken little interest in the Audit Office itself. This is evident in a number of ways.

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16. House of Commons, First Special Report from the Committee of Public Accounts, Session 1980-81, The Role of the Comptroller and Auditor-General, Volume 1, Report, HMSO, London, 4 February 1981, p. li, liv.

5.49 First, it was only in November 1985 that an Auditor-General presented the first separate annual report to Parliament. This may come as a surprise since the post of Auditor-General has been a statutory office since 1901. During the intervening years, Auditors-General commented on aspects of their administration of their statutory functions in a few pages of attachments to their reports on the Minister for Finance's financial statements. Amendments to the Audit Act requiring the Auditor-General to submit an annual report to Parliament were passed as recently as 1987 (sections 11A, 48G).

5.50 Second, the Auditor-General is appointed by the Governor-General on the advice of the Prime Minister. Parliament has no role in his appointment.

5.51 Third, the PAC never met with the first Independent Auditor of the AAO in the eight years of that person's appointment. Consequently, the PAC itself did not utilise that person's knowledge and take a lead in pursuing questions associated with the condition of public sector auditing, (see Chapter 15).

5.52 Development of the role of the Auditor-General and his Office outlined in this report is likely to lead to greater Parliamentary interest in public sector audit. The Committee wishes to promote this interest further by recommending that Parliament examine the Audit Office's estimates separately in addition to the usual scrutiny by a Senate Estimates Committee. Presently a Senate Estimates Committee reviews the Audit Office's estimates alongside those of the Department of Finance. This arrangement does not give sufficient time for the Audit Office's estimates to be examined in detail, since they are overshadowed by estimates of the larger departments and other agencies which are also considered by the same Senate Committee<sup>17</sup>. The latter considered estimates of three major portfolios, and the many organisations within each portfolio. Notwithstanding, it is still appropriate for the Audit Office's estimates to be examined by a Senate Estimates Committee. However, Audit Office estimates should be considered with those of Parliament and not in conjunction with those of the Department of Finance.

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17. 1988-89 AAO estimates were considered by Senate Estimates Committee C, which also considered estimates of:

- . Department of Finance;
- . Department of Employment, Education and Training;
- . Department of the Treasury
- . Australian Bureau of Statistics;
- . Industries Assistance Commission;
- . Australian Taxation Office;
- . Insurance and Superannuation Commission;
- . Many smaller Government agencies.

Australian Senate Estimates Committee C, Report to the Senate, November 1987.

5.53 The Committee recommends that:

The Australian Audit Office's appropriations be included in the Appropriation (Parliamentary Departments) Bill<sup>18</sup>.

5.54 The Public Accounts Committee recommends establishment of a separate parliamentary committee to consider and recommend on the Audit Office's annual appropriation. This committee, which would meet from time to time, would have the major responsibility for advising Parliament on variations in the Audit Office's budget within variations in estimates of Parliamentary departments. It would function by considering the Auditor-General's proposed annual level of activity, and would have the authority to recommend to the Auditor-General issues or matters for audit. Other Parliamentary committees would also maintain the right to suggest topics for audit by the Auditor-General. This would be an advisory framework for the Auditor-General's decisions on priorities. As now, the holder of that office would not be obliged to accept recommendations of Parliamentary committees. Thus, there would be no change to independent exercise of his judgement, but he would have more frequent advice from Parliament on matters it thought important for improving the efficiency and effectiveness of Government administration. Maintenance of his independence in this new system of resource determination would be fundamental to maintaining the office-holder's freedom from political interference.

5.55 The direction of this change parallels developments in the British Parliament which has a similar committee called the Public Accounts Commission. In other words, formation of an audit committee of Parliament has a precedent and is consistent with the Westminster Parliamentary system.

5.56 The membership of the committee established to advise Parliament on the Audit Office's annual appropriation would have the crucial role of avoiding appearing to determine the Auditor-General's priorities. Therefore, the committee must have members from Government and Opposition and from both Houses of Parliament. In order that the committee be informed of the Government's expenditure priorities for the entire public sector, the Minister for Finance should be a committee member. Committee membership should be drawn from but not necessarily confined to the other principal Parliamentary committees which utilise the Auditor-General's reports. The Committee should appoint its own Chairperson. It would be better if the Chairperson were not the Minister for Finance because the latter's very heavy workload would prohibit him from devoting the necessary time to the task.

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18. A relevant report on this Bill and related matters is: The Parliament of the Commonwealth of Australia, Parliament's Appropriations and Staffing Report of the Senate Select Committee, Parliamentary Paper No 151/1981, AGPS, Canberra, 1981.

5.57 The Committee recommends that:

- . 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 will 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.

5.58 These recommendations follow similar principles to those outlined in the National Audit Act 1983 in the United Kingdom.

5.59 The above recommendations would mean that the Government always had a majority of members on the Audit Committee of Parliament. Since the Minister for Finance would be a member, AAO resource bids would be subject to the same level of analysis and evaluation as for other departments. The AAO's estimates would be included in the Appropriation (Parliamentary Departments) Bills, and considered by a Senate Estimates Committee in the usual way. This would be the second level of Parliamentary scrutiny referred to earlier.

5.60 The departure from current practice would be that the executive would not have sole responsibility for advising on the AAO's appropriations. Responsibility would be shared with the legislature, or with Parliament as a whole. An objection is that these proposals do not sit easily with the convention that only the executive puts expenditure proposals to Parliament. This principle would not be infringed since the AAO's estimates would be included in Appropriations Bills as they are now. However, the process by which forward estimates would be arrived at would be very different and consistent with the principle that the entire Parliament has a special interest in maintenance of an independent and able Audit Office.

## Chapter 6

### APPOINTMENT OF THE AUDITOR-GENERAL AND OF AUSTRALIAN AUDIT OFFICE STAFF

#### Appointment of the Auditor-General: An Officer of Parliament

6.1 Currently, the executive:

appoints the Auditor-General;  
determines the Auditor-General's resources;  
determines his staff numbers and staff  
classifications; and  
is responsible for administering financial  
management provisions of the Audit Act 1901  
through the Minister for Finance.

6.2 The Auditor-General reports to Parliament. His status as an officer of the executive or of the Parliament is ambiguous. Executive government has contributed to the equivocal nature of his position. For example, the May 1988 Economic Statement's discussion of 'Reform of Commonwealth Business Enterprises' in the Transport and Communications Portfolio indicated that<sup>1</sup>:

...the current large number of Government controls over day-to-day operations will be virtually all removed or substantially relaxed...

...the requirement to use the Commonwealth Auditor-General will be removed, except in the case of Telecom and Australia Post in reflection of their large non-commercial activities.

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1. Economic Statement May 1988, Statement delivered on 25 May 1988 by the Honourable P J Keating, MP, Treasurer of the Commonwealth of Australia.

6.3 Identification of the Auditor-General as a Government control promoted the appearance of the Auditor-General as a member of the executive. More correctly, the Auditor-General is not another Government control such as arrangements (also listed in the May Economic Statement) to co-ordinate industrial relations matters, or the requirement for government business enterprises, GBEs, to rely on the Commonwealth Superannuation Scheme. The position of Auditor-General was established to maintain the accountability of the administration to Parliament. As Government has loosened its executive controls, the need for accountability remains and should be strengthened.

6.4 The executive is accountable to Parliament for stewardship of its resources. The Audit Act affirms that the Auditor-General is the executive's external auditor who has the statutory responsibility of reporting to Parliament on his audits. Thus, there is a 'natural' tension in the Audit Office's relationship with the executive because the Auditor-General must be both independent from and responsive to the executive.

6.5 British audit legislation sought to reduce the ambiguity in the Auditor-General's role vis-a-vis the executive by stating that<sup>2</sup>:

The Comptroller and Auditor-General shall by virtue of his office be an officer of the House of Commons.

6.6 The Committee agrees with the report on the role of the Auditor-General written by the British PAC which affirmed that<sup>3</sup>:

The (Auditor-General) audits the Appropriation Accounts 'on behalf of the House of Commons'. He is the external auditor of Government, acting on behalf of the taxpayer, through Parliament, and it is on his investigations that Parliament has to rely for assurances about the accuracy and regularity of Government accounts.

6.7 The Committee recommends that:

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.

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2. National Audit Act 1983, section 1(2).

3. House of Commons, op. cit., 1981.

## Method of Appointment

6.8 Section 3 of the Audit Act 1901 states that:

The Governor-General may appoint some person to be Auditor-General for the Commonwealth.

6.9 No mention is made of who makes recommendations to the Governor-General. In practice, the Prime Minister advises the Governor-General after a recommendation by the Minister for Finance.

6.10 In other words, the recommendation is based on advice from the executive. Parliament has no role. This is consistent with the Auditor-General being answerable to Parliament through the executive.

6.11 The Committee believes that Parliament should play a stronger role in public sector audit.

6.12 The Committee recommends that:

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.

6.13 These recommendations would raise Parliament's stake in the appointment, and ensure a continuity of Parliamentary interest in the incumbent's performance.

## Qualifications

6.14 Section 3 of the Audit Act 1901 states that:

The Governor-General may appoint some person to be Auditor-General for the Commonwealth.

6.15 The Act does not specify what skills or qualifications

an Auditor-General must have. The Committee carefully considered whether legislation should require the Auditor-General to be a qualified accountant. Arguments in favour of this requirement include:

the reasonableness of the expectation that the nation's chief auditor should be appropriately qualified; and

enhancement of the AAO's image as a centre of auditing excellence.

6.16 Arguments against the requirement were that:

incumbents have not always been qualified accountants yet they performed the role appropriately;

greater emphasis on efficiency audits means that skills other than accounting have become crucial to public sector audit; and

there are other ways to raise the Audit Office's image as a centre of excellence.

6.17 While accepting that accountancy qualifications are of great importance, the Committee believes that there are circumstances where the other qualifications of an outstanding candidate may hold greater sway.

## **Duration of Appointment**

6.18 Section 5A of the Audit Act 1901 states that:

The Auditor-General shall cease to hold office upon attaining the age of sixty-five years.

6.19 In other words, Auditors-General are appointed for the duration of their working life. The reason is that this guarantee of permanent employment protects the integrity of the office-holder's judgement. This legislative provision appears to have worked well. However, it is timely to consider whether it is as appropriate as at Federation, and whether there are other ways of protecting the Auditor-General's independence.

6.20 An argument against appointment for the duration of a person's life is that such a provision discriminates against appointment of a younger man or woman. A person appointed, say, at the age of 40 years could remain Auditor-General for a quarter of a century. Any group of selectors is faced with a daunting task to

select wisely so far ahead. Of note is that the two previous Auditors-General each served for only few years before retirement. An Auditor-General can resign whenever he or she so desires.

6.21 Since there are no calls to abandon lifetime appointment of High Court justices, why then should lifetime appointment of an Auditor-General be questioned? The reply is that there is only one Auditor-General while there are many justices, including several justices of the High Court. There is less room for error when there is only one office-holder.

6.22 Term appointments have become common for non-judicial positions. For example, the Commonwealth Ombudsman and the Director of Public Prosecutions are appointed for maximum periods of seven years. An appointment for an extended period rather than for life would permit the introduction of new ideas to the Audit Office via the Auditor-General. Benefits to the Audit Office from some turnover in the position of Auditor-General have been evident from appointments in recent years, including from the current appointment, to the post. The problem is to decide on the duration of the appointment necessary to protect the position while simultaneously legitimising some turnover of office-holders. The Auditor-General of Canada is appointed for ten years. This term seemed to balance the above concerns.

6.23 The Committee recommends that:

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.

## Salary

6.24 Section 4 of the Audit Act 1901 affirms that:

The Auditor-General shall be paid such remuneration as is determined by the Remuneration Tribunal.

6.25 The Committee does not see any reason to change this provision<sup>4</sup>.

6.26 \$104 000 was allocated in 1988-89 for the

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4. It was interesting to note that the Auditor-General complained in 1918 that his salary had not increased since his appointment in 1901, although the salaries of all other high-ranking Government officials had increased substantially. Special Report, op. cit., p.5.

Auditor-General's salary and allowances<sup>5</sup>. In comparison, partners in medium and large city accounting firms in March 1988 could expect to earn \$180 000 per annum<sup>6</sup> with senior partners earning much more than this in salaries and benefits. The Australian Government cannot expect to attract top private sector persons to the position of Auditor-General when income differences are so great. Government must be cognizant of this fact in evidence before the Remuneration Tribunal. A factor which cannot be ignored is the prestige or public recognition associated with appointment to such a high office. The taxpayer will gain if the Audit Office's status improves and the quality of its work is even higher than now. However, these benefits have costs. To avoid confronting the difference between the Auditor-General's income and the income of senior partners of large accounting firms is to avoid confronting the problem of how to improve the quality of public sector audit.

6.27 This is not to suggest that the only or the best approach to improving public sector audit is to double the Auditor-General's salary. There are two streams of senior audit positions in this country, one in the private sector and the other in the public sector, with little movement of experienced auditors between. One Committee objective is to foster movement of senior staff between the two sectors in order that both may gain. It is with this in mind that the incomes issue was raised.

6.28 The Committee searched for other public sector positions to use as benchmarks for the Auditor-General's salary. There are no exact parallels. The Committee noted that, in Canada, the Auditor-General's salary is the same as for a justice of the Supreme Court. This linkage acknowledged the importance and status of the position of Auditor-General.

## Retirement Provisions

6.29 If future Auditors-General are to be appointed for a fixed term rather than for the duration of the incumbent's working life, then maintenance of the integrity of the audit opinion will require more attention to retirement provisions for the post. An extreme case would be where there were no retirement provisions, for example, no superannuation. This omission would be a deterrent to many people otherwise interested in the job. Alternatively, if executive government paid retirement benefits according to whether it agreed with the Auditor-General's reports, then the position would be compromised.

6.30 It is doubtful whether current superannuation provisions

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5. Explanatory Notes 1988-89, Finance Portfolio, Explanation of Actual Outlays 1987-88 and Estimated Outlays 1988-89, Budget Related Paper No. 8.7, Commonwealth Government Printer, Canberra, 1988, p.104.

6. Chartac Accounting Report, March 1988.

are attractive to partners of private sector audit firms. This inadequacy limits the size of the pool of persons from which an Auditor-General can be appointed.

6.31 Retirement provisions, or superannuation and other entitlements accruing on conclusion of an appointment, should be at the same level as for other statutory office holders.

## Termination of Appointment

6.32 Section 7 of the Audit Act 1901 affirms that:

The Auditor-General shall hold his office during good behaviour and shall not be removed therefrom unless an address praying for such removal shall be presented to the Governor-General by the Senate and the House of Representatives respectively in the same session of Parliament.

The Governor-General may at any time suspend the Auditor-General from his office for physical or mental incapacity, incompetence or misbehaviour: and when and so often as the same shall happen the Minister shall lay before both Houses of the Parliament a full statement of the grounds of such suspension...

6.33 In amending the Audit Act, the Committee suggests that the power to suspend the Auditor-General should be in the hands of Parliament rather than with the Executive. Section 72 of the Constitution, which outlines arrangements for the appointment of High Court Justices, provides appropriate guarantees for the security of the position of Auditor-General<sup>7</sup>. Wording of section 7 of the Audit Act appears to be based on section 72 of the Constitution but with more power to Executive Government as indicated previously.

6.34 The Committee recommends that:

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.

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7. The Australian Constitution, as altered to 1 January 1988, together with an explanatory note about the Constitution, Constitutional Commission, AGPS, Canberra, 1988, Section 72.

## Appointment of Audit Office Staff

6.35 The Department of Finance has influence over the Audit Office because of its recommendatory powers over the latter's running costs. DOF determines the number of SES positions the Audit Office may have and their classifications in accord with Government guidelines. However, the Auditor-General can reclassify his SES staff upwards provided there are savings in expenditures on SES salaries or with the number of SES positions. The Auditor-General can also vary downwards the classifications of his SES staff. Finance and the Audit Office determine a staffing profile for the Audit Office, although Finance does not instruct Audit on how many staff it can employ. Rather, the Department's control over the salaries vote is the control mechanism.

6.36 These procedures and mechanisms are also applied by the Department of Finance to executive departments. In combination, they result in great Departmental influence over what resources are available and how resources can be deployed.

6.37 Audit Office staff are employed according to the terms and conditions of employment set out in the Public Service Act.

6.38 The above executive government controls over the Auditor-General's staff are inconsistent with the role of the Auditor-General being independent from the executive. Also, the arrangements add to the confusion over to whom is the Auditor-General responsible, executive government or to Parliament.

6.39 This inconsistency has been acknowledged in Canada and Great Britain, where Auditors-General have the authority to recruit and dismiss staff and to determine their classifications. New audit legislation introduced into the New Zealand Parliament will also give the New Zealand Auditor-General the freedom to employ those persons best able to assist the Auditor-General to perform his responsibilities.

6.40 The effects of these controls have been to perpetuate gross inequities in incomes between AAO staff and their private sector peers. For example, the AAO officer responsible for audit of the Commonwealth Bank earns approximately one third or one quarter the income of partners in accounting firms which audit large private sector banks. In 1987-88, of 85 persons recruited to the AAO, only 3 were recruited from the private sector. Clearly, the AAO has lost its attractiveness to audit staff.

6.41 A further effect has been to severely constrain the

AAO's ability to respond adequately to increased responsibilities. This is evident in how the AAO has three Division Heads, or First Assistant Secretaries, responsible for the conduct of audits. This is the same number of Division Heads with field management responsibilities as the AAO had a decade previously when its workload was markedly less.

6.42 Current staffing controls on the Australian Audit Office prohibit the Auditor-General from major re-organisation of the Office. For example, there are strictures on his power to form audit teams similar to those used by large audit firms. Audit firms have a partner to other audit staff ratio of approximately 1:11 or 1:12<sup>8</sup>. If SES staff are equated with the level of partner in private firms, the ratio of SES to other audit staff is approximately 1:24. This latter ratio cannot be changed to any great extent under current arrangements.

6.43 If the current number of non-SES staff were maintained, the AAO would require an additional 16 SES to have the same partner to staff ratio as in large accounting firms. This would cost an additional \$4.3m<sup>9</sup>. Alternatively, if the AAO's 1987-88 budget were maintained and the objective were to obtain a ratio of 1 SES to 11.4 other staff (the same average as in large accounting firms), then there would be 46 SES and 524 other staff, or 570 staff in total, compared with actual 1987-88 staffing of 24 SES and 595 other officers, or a total staff of 619<sup>10</sup>.

6.44 A particular concern is that the Audit Office has lost many audit staff who had specialised in the application of computers to audit. They were recruited by private audit firms at far higher salaries. Their loss has affected the Audit Office's responsiveness and ability to utilise computers in the audit task.

6.45 Government controls have also limited the Auditor-General's ability to develop a team of specialists in the various accounting disciplines, and to recruit taxation specialists and actuaries. Skills which these persons have are necessary to permit the Audit Office to respond to changes in the nature of its work.

6.46 In other words, certain approaches to raising AAO productivity cannot be explored due to a combination of the Public Service Act and Government policy administered by the Department of Finance. There is a pressing need for the Auditor-General:

to re-organise the AAO to reflect better his charter;

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8. Chartac Accounting Report, October 1988.

9. C Monaghan to Secretary, JPCPA, 11 January 1989.

10. C Monaghan to Secretary, JPCPA, 6 February 1989.

to give greater attention to recruitment of talented young auditors;

to be able to offer financial incentives to current able staff to stop the AAO's human resources continuing to haemorrhage; and

to offer higher salaries to attract senior private sector auditors.

6.47 The Committee recommends that:

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<sup>11</sup>.

6.48 Implementation of this recommendation would mean that the Department of Industrial Relations would adopt a monitoring role of Audit Office employment conditions, as it does with other statutory authorities which have their own establishment legislation such as the Commonwealth Bank, Qantas and OTC. More importantly, it would end the anomaly whereby the AAO is an outrider of the Department of Finance.

## Senior Appointments from The Private Sector

6.49 The Audit Office could diversify its skill base by recruiting on contract more persons from the private sector to positions of leadership. However, there are serious disincentives for potential private sector applicants.

6.50 The longer the duration of a term appointment, the more income a private sector appointee would forsake. Also, the more difficult it would be for the appointee to establish himself or herself in private practice after the term of appointment ends.

6.51 No matter how much discretion the Auditor-General may be given over staff salaries, he or she will never be able to match private sector salaries. Therefore, other means must be found to attract quality private sector staff to leadership positions.

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11. This recommendation is a re-expression of the recommendation of the Royal Commission on Navy and Defence Administration which in 1918 urged that the Auditor-General's staff should be placed outside the operations of the Commonwealth Public Service Act. Royal Commission on Navy and Defence Administration, op. cit., p.10.

6.52 The Committee recommends that:

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.

6.53 The Committee is conscious that acceptance of this recommendation would do nothing to reduce the injustice associated with senior auditors in the public and private sectors undertaking identical work at vastly different incomes.

## Delegation

6.54 Of importance to the Auditor-General's authority to organise his Office most appropriately to meet his responsibilities is his power to delegate.

6.55 Section 70BA gives the Auditor-General the authority to delegate to others the signing of audit reports on his behalf. Since the early 1980s, the Auditor-General has used this section of the Act to authorise Division Heads to sign audit reports. From early in 1988, the Acting Auditor-General delegated his authority to sign audit reports to other SES staff and to Regional Managers in the ACT, New South Wales and Victoria, where there are large numbers of auditees.

6.56 The Auditor-General is appointed under the various Companies Codes to be the auditor of Government companies. The Code requires that the audit report be signed by a registered company auditor, and it specifies that the Auditor-General is the only registered company auditor in the AAO. Consequently, the Auditor-General must sign personally all audit reports on Government companies.

6.57 The Committee recommends that:

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.

## Chapter 7

### STATUTORY MARKETING AUTHORITIES

7.1 Statutory Marketing Authorities, SMAs, occupy a significant place in the economy since export sales of rural products contribute over one-third of total export income, with 80 per cent of rural exports derived from industries in which SMAs operate. In 1986 there were ten Statutory Marketing Authorities within the Commonwealth Primary Industry Portfolio. These were established at the request of industries to perform functions on their behalf and they are funded by the industries concerned either through statutory levies or from sales of produce. They are not Budget funded. In its January 1986 White Paper on Statutory Marketing Authorities, the Government stated that it intended the authorities to continue to operate commercially and to continue to be self-financing<sup>1</sup>.

7.2 Subsequently, legislation for SMAs was amended to give each authority the option of appointing a private audit firm as its external auditor.

### New Audit Reporting Requirements

7.3 When the Auditor-General was an external auditor of an SMA, he was required by the Audit Act to prepare<sup>2</sup>:

a report on the authority's financial statements. Both the financial statements and the associated report were tabled by the responsible minister; and

a report to the minister on audits, examinations and inspections. If the contents of this report were considered by the Auditor-General to be important, a summary may have been included in a later Auditor-General report to Parliament.

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1. Department of Primary Industry, Reform of Commonwealth Primary Industry Statutory Marketing Authorities. A Government Policy Statement, AGPS, Canberra, January 1986.

2. C Monaghan to Secretary, JPCPA, 10 August 1988.

7.4 1987 amendments to the Audit Act and to enabling legislation for SMAs changed these arrangements. Now, when an SMA appoints a private audit firm, reporting arrangements will be as follows:

the audit firm will report on the SMA's financial statements to the minister, who will table in Parliament the financial statements and the associated audit report;

the audit firm must report to the SMA's minister at least once a year on its accounts and records audits (section 63G). No audit report on accounts and records will be provided to Parliament;

the Auditor-General can provide a separate report to the SMA's minister and to Parliament on the SMA's financial statements;

the Auditor-General may choose to audit an SMA's accounts and records and report to the minister and Parliament (section 63MC); and

The Auditor-General may report to the SMA's minister and to Parliament on whether the private auditor has complied with AAO audit standards.

## **Australian Wheat Board**

7.5 To date, the Australian Wheat Board, AWB, is the only SMA to take advantage of the new provision in its legislation through appointment in December 1987 of a private audit firm instead of the AAO as its external auditor.

7.6 The Committee invited the Australian Wheat Board to appear before it to discuss its reasons for switching from the Australian Audit Office to a private audit firm. AWB representatives gave four reasons for preferring a private audit firm, as follows<sup>3</sup>;

lower cost;

commercial orientation, including more interaction with the private sector;

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3. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 21 July 1988, p.1050-1085.

wide client base and type of interaction between management and commercial auditors; and

access to modern computerised accounting technology to assist in closing the accounts.

7.7 On closer examination, estimated cost savings were marginal, if any. The AAO has a very wide client base, while AWB representatives indicated that the client relationship and the relationships between AWB and AAO staffs was very good. Certainly private audit firms have more interaction with the private sector. The private audit firm selected had access to computer software which could assist the AWB in closing its accounts. Strictly speaking, however, the latter was not an audit function.

7.8 There were other factors which the Committee considered on this matter. Over several years, the AAO had criticised the form, content and timeliness of the AWB's financial reporting. Also, the AAO had qualified its audit of the AWB for eight consecutive years. These inadequacies had attracted the attention of the former Senate Standing Committee on Finance and Government Operations, (Third and Sixth Reports). Following sustained pressure from the AAO in fulfilment of its statutory obligations, the AWB produced for the year ended 30 September 1985 timely financial statements which complied with the Minister for Finance's guidelines. That year for the first time in eight years, the AAO issued an unqualified audit report on the AWB<sup>4</sup>.

7.9 Both the AWB and the Minister for Primary Industry appreciated the AAO's assistance as was shown by unsolicited written documentation from the AWB's Chairman and from the Minister in 1987.

7.10 When all of the above was considered, it was clear that the AAO over many years had played a key role in ensuring that the AWB's financial management was of an appropriate standard and that Parliament was fully informed of the state of play. This was acknowledged by both the Chairman of the Wheat Board and by the Minister. Therefore, the Committee noted with surprise that the AWB had changed its auditor.

7.11 One consideration is that the Committee's discussions were held only seven months after the appointment of the new auditor, and the potential benefits of the change of auditor will not become obvious until a minimum of one year's financial statement has been audited.

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4. J Monaghan to R Tickner, 1 December 1987.

7.12 Considering all of these factors, the Committee did not believe that the AWB had sufficient reasons to move to a private audit firm. This is not a commentary on the firm which assumed the AAO's previous responsibilities, since that firm is held in high regard professionally.

7.13 The 1987 amendments required the Committee's agreement to the appointment of a commercial auditor for any of the SMAs. PAC approval was given for the appointment of a private audit firm as the AWB's external auditor, (see below).

## **Restoration of the Auditor-General as External Auditor**

7.14 Changes in reporting requirements may appear to strengthen an SMA's accountability because of overlapping or reinforcing provisions in the SMA's legislation and in the Audit Act concerning the private audit firm and the Audit Office.

7.15 Notwithstanding, there are many inadequacies with the new arrangements:

no improvement in SMA's accountability to their industries through appointment of private audit firms. There was no suggestion at the introduction in 1987 of amendments to SMA legislation that inclusion of private audit firms' reports would improve SMA's accountability to their industries. Yet the new legislation appears to have given the mistaken impression that these were linked. Of note is that nine of the ten SMAs within the Primary Industry and Energy Portfolio have improved their relationship with industry through implementation of the 1987 amendments while maintaining the Auditor-General as the external auditor;

unnecessary duplication since SMAs which opt for private audit firms will have two auditors, the private audit firm and the AAO. The AAO's role will continue for the duration of the private audit firm's appointment;

high audit costs as a direct result of the potential for duplication of audit effort;

dependency of the Auditor-General on private audit firms. The new two auditor arrangements make the

Auditor-General very dependent on private audit firms when the former is advising Parliament on an SMA's accounts, records and financial statements. This need not be a hindrance if private audit firms were responsible to the Auditor-General as well as to the SMA and its industry. However, this is not the case since private audit firms are required to submit reports to the relevant minister with only the copies to be given to the Auditor-General (section 63MD);

lateness of the Auditor-General's reports. The Auditor-General will not be in a position to decide whether he will provide a separate report until some time after he has received the private auditor's report. If he so decides, then there would be two audit reports on financial statements, probably separated by some months.

This change in the timing of access to financial statements will result in other AAO work assuming higher priority. Consequently, the AAO's role in auditing SMAs will weaken;

superficial nature of Parliament's involvement in the appointment of private audit firms. The PAC must approve the latter's appointment. However, the PAC's role is perfunctory and merely confers the appearance of private audit firms being accountable to Parliament without that appearance having substance; and

weakening of the accountability of SMAs to Parliament. Private audit firms do not have to report to Parliament, only to the minister. This contrasts with previous arrangements whereby the Auditor-General was required to report to Parliament. It is not clear who gains from removal of this requirement.

7.16 It is evident that 1987 amendments to the enabling legislation of statutory marketing authorities has created a situation whereby, if private audit firms are appointed as SMAs' auditors, then:

the benefits to SMAs are doubtful;

private audit firms will not like the double audit arrangements;

the Auditor-General is in a weaker position from which to exercise his responsibilities; and

Parliament's ability to call SMAs to account is diminished.

7.17 The Committee recommends that:

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

7.18 The Australian Wheat Board's contract with its private audit firm should continue until the contract expires.

7.19 A mechanism would be necessary to permit SMAs to request the Auditor-General to appoint a private audit firm on contract to the Auditor-General. Since change of auditor would imply a criticism of the Auditor-General, it would be appropriate for an SMA's request to be made through its minister. The latter would have the authority to support or to deny the request. Final authority to accede to such a request would rest with the Auditor-General.

7.20 The Committee recommends that:

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 appoint a private audit firm as contract auditor under section 11 of the Audit Act 1901.

7.21 The above recommendations would:

remove ambiguities concerning the identity of SMAs' external auditors by restoring the Auditor-General to his previous role;

place new emphasis on those provisions of the legislation which permit the Auditor-General to hire auditors on contract; and

permit SMAs to be audited by private audit firms where SMAs believed there were advantages.

7.22 Acceptance of such a recommendation would not require amendment to the Audit Act, but amendments would be necessary to SMA legislation.

## Chapter 8

### THE AUDIT ACT AND THE COMPANIES ACT AND CODES

8.1 Commercially oriented government instrumentalities generally take the form of statutory authorities or companies<sup>1</sup>. In the case of the former they are created and operate under the provisions of a specific Act of Parliament which sets out their functions and powers and defines their audit requirements. They are required to keep accounts in accordance with commercial practice. This can be ensured, first, through the organisation's enabling legislation which can indicate that Part XI Division 2 of the Audit Act applies, or, second, the enabling legislation itself can contain similar provisions to the Audit Act.

8.2 In the case of companies, these are created under the provisions of the Companies legislation<sup>2</sup>. Their functions and powers are contained in their Memorandum and Articles of Association. The Companies Code sets out requirements for the appointment of auditors, and the form and content of audit reports to shareholders.

8.3 Companies may be directly owned by the Government, in which case the shares are held by the Commonwealth with the minister as the representative of the shareholder for voting purposes. Directors may hold shares in trust for the Government. Qantas Airways Limited and Australian Airlines Limited are examples of this type of arrangement.

8.4 However, the majority of public sector companies are indirectly owned by the Government as they are wholly owned subsidiaries of statutory authorities or other government owned

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1. Professor R. Walker of the University of New South Wales and Mr G. Williams of the AAO provided valuable assistance in interpretation of the Companies Act and Codes and the Audit Act.

2. Companies legislation comprises the Companies Act 1981 for the A.C.T., and the Companies Code enacted in all States and the N.T.

companies. In these cases the shares are held by the parent body and directors may hold shares in trust for the parent body<sup>3</sup>.

8.5 Where a government owned company is not audited by the Auditor-General, the auditing arrangements and subsequent reporting are limited to those contained in the Companies legislation and common law. Where the Auditor-General is the auditor there is a dual appointment under both the Companies legislation and section 63P of the Audit Act. Section 63P provides the legal authority for the Auditor-General to carry out audits under the Companies Code and contains provisions which require the Auditor-General to report the results of the audit to the responsible Minister.

## The Audit Act

8.6 The Audit Act sets out the following audit responsibilities of the Auditor-General. Section 63G of Part XI describes the Auditor-General's responsibilities in regard to audits of accounts and records as follows:

- (1) The Auditor-General shall inspect and audit the accounts and records of financial transactions of the authority and records relating to assets of, or in the custody of, the authority, and shall forthwith draw the attention of the appropriate Minister to any irregularity disclosed by the inspection and audit that is, in the opinion of the Auditor-General, of sufficient importance to justify his so doing.
- (2) The Auditor-General may, at his discretion, dispense with all or any part of the detailed inspection and audit of any accounts or records referred to in sub-section (1).
- (3) The Auditor-General shall, at least once in each year, report to the appropriate Minister the results of the inspection and audit carried out under sub-section (1).

8.7 The Act does not require the Auditor-General to report on internal controls, although any deficiency identified and judged by him or her to be sufficiently important must be reported under section 63G. The Auditor-General's auditing standards require an audit of internal controls<sup>4</sup>.

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3. There are no known instances of Commonwealth departments creating separate companies, although this has happened in at least one State.

4. Commonwealth of Australia, Gazette, 'Notice by Auditor-General Setting Auditing Standards,' Friday 7 August 1987.

8.8 Section 63H describes the Auditor-General's responsibilities in respect of the audit of financial statements as:

- (2) Before submitting financial statements to the appropriate Minister....., the authority shall submit them to the Auditor-General, who shall report to the appropriate Minister -
  - (a) whether, in his opinion, the statements are based on proper accounts and records;
  - (b) whether the statements are in agreement with the accounts and records and, in his opinion, show fairly the financial transactions and the state of the affairs of the authority;
  - (c) whether, in his opinion, the receipt, expenditure and investment of moneys, and the acquisition and disposal of assets, by the authority during the year have been in accordance with the enactment establishing the authority; and
  - (d) as to such other matters arising out of the statements as the Auditor-General considers should be reported to the appropriate Minister.
- (3) The appropriate Minister shall cause copies of the report and financial statements together with a copy of the report of the Auditor-General to be laid before each House of the Parliament within 15 sitting days of that House after their receipt by the appropriate Minister.

8.9 Section 63R further defines the Auditor-General's responsibilities as follows:

- (1) The Auditor-General shall report on all cases in which, in the opinion of the Auditor-General, the receipt, expenditure or investment of money, or the acquisition or disposal of assets, by a statutory body was not in accordance with the enactment by or under which the body was established.

8.10 Section 63P states that:

- (1) The functions of the Auditor-General.... extend to the carrying out, at the discretion of the Auditor-General -
  - (aa) of the audit of all or any of the financial statements of a body:
    - (i) where a Minister requests the Auditor-General to carry out the audit and arranges with the body for the financial statements, and any necessary accounts and records, to be made available for the purpose;...
    - (a) of an inspection and audit...of the accounts and records of a body...;
  - (2) The Auditor-General may, at the request of a Minister, make an arrangement with a body for the carrying out by the Auditor-General of the audit of financial statements of the body or the inspection and audit of the accounts and records of the body...
  - (2A) ...the Auditor-General shall report to the Minister on the audit or inspection and audit, as the case may be.

## Companies Code

8.11 Subsection 285 (1) of the Companies legislation states that the auditor must report to the company's members. Subsection 285(2) does not require the auditor to report to directors, only to give them a copy of his or her report in time for it to be included in an annual report to be furnished to members so that an annual general meeting can be called within the prescribed time frame. Subsection 285 (3) affirms that the auditor must report:

- (a) whether the accounts and, if the company is a holding company for which group accounts are required, the group accounts are in his opinion properly drawn up-
  - (i) so as to give a true and fair view of the matters...to be dealt with in the accounts and, if there are group accounts, in the group accounts;
  - (ii) in accordance with the provisions of this Code; and

(iii) in accordance with applicable approved accounting standards.

8.12 Subsection 285(4) states that:

It is the duty of an auditor of a company to form an opinion (on)...

(b) whether proper accounting records and other records, including registers, have been kept by the company as required by this Code.

8.13 Auditors are not required to report to members on the adequacy of internal controls or whether transactions have been properly authorised in terms of procedures laid down by management, or whether they have detected fraud.

8.14 Australian auditing standards direct an auditor<sup>5</sup>:

to gain an understanding of the accounting system and related internal controls, and

to study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

8.15 This auditing standard views the examination of internal controls as a step in the process of expressing an opinion on financial statements, rather than as a component of an audit.

## Comparison

8.16 Comparison of the requirements of the Audit Act and the Companies legislation revealed the following patterns:

Both require the auditor to report on the organisation's financial statements. The Companies legislation auditor is required to give a 'true and fair view', while the Audit Act auditor must indicate 'whether the statements are in agreement

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5. Auditing Standards, I, ASA and ICA, Sydney, March 1987.

with the accounts and records... and show fairly ...' The significance of the difference between these requirements is not clear. In practice, there appears to be little difference.

Both have the effect of requiring audit reports on the financial statements of Commonwealth owned instrumentalities to be provided to the auditee's minister. The Audit Act requires a report to the minister and for an annual report, which contains the audit report, to be provided to Parliament. The Companies Code requires a report to a company's members. As described earlier, the Commonwealth Government customarily holds all shares in government companies with the minister as the representative of government for voting purposes. Company directors may each hold one share in trust for the Government. However, in the case of subsidiary companies the minister is not normally a member.

Neither compels reporting on the adequacy of internal controls, although it is common practice to do so. However, the audience for these reports is different. The Auditor-General is far more likely to report publicly about weaknesses in internal controls than is usual in the private sector where they are rare. As mentioned, these reports are to the minister and, if sufficiently important, to Parliament. It is more common for company auditors to report privately to management rather than to company members about internal control weaknesses.

The Audit Act requires the auditor to report whether proper accounts and records have been kept and to report to the minister and to Parliament. The Companies legislation also requires the auditor to determine whether proper accounting records have been kept. However, it is rare to find reference to inadequate records in company audit reports, perhaps because auditors interpret the provision as relating only to deficiencies that subsequently have not been rectified.

For statutory authorities, the Audit Act requires the auditor to report whether the authority has complied with the provisions of the enabling legislation. The Companies Code has no equivalent requirement. In other words, there are no statutory requirements for company auditors to publicly report on whether management has breached enabling legislation or any other law. The

Australian accounting profession has not devised guidelines about auditors' responsibilities to report on illegalities.

Companies legislation requires all companies except exempt proprietary companies to file their annual reports, which include financial statements and the auditor's report on those statements, with State Corporate Affairs Commissions as delegates of the National Companies and Securities Commission. In other words, the audit report on financial statements is a public document.

Subsection 5(1) of the Companies legislation defines 'Exempt proprietary company' as a proprietary company -

(a) no share in which is ...deemed to be owned by a public company, and

(b) no member of which is a public company.

A Commonwealth-owned company could be incorporated as a proprietary company in terms of section 34 of the Companies legislation, and hence fit the test of an 'exempt proprietary company.' If the latter has been in operation for at least one year, it is offered a choice between appointment of an auditor or a public filing of its key financial data such as total assets and liabilities, and operating and after-tax profit. The option is between filing of the financial statement without the audit report, or filing the audit report (and only if this is qualified) without the financial statement. Declaration of a Commonwealth instrumentality as an exempt proprietary company risks removing the requirement on these organisations to report publicly on their financial statements and other matters mentioned in section 285.

## Implications

8.17 The implications for accountability to Parliament of the audit of a government instrumentality being conducted under the Companies Code rather than the Audit Act are as follows:

- (a) no requirement of the minister to table in Parliament the instrumentality's annual financial statements and the audit report on the financial statements;

- (b) if government enterprises are incorporated as exempt proprietary companies there may not be any public disclosure of financial information;
- (c) elimination of any vehicle for the auditor to report to Parliament except where the Auditor-General has dual appointment;
- (d) Parliament will no longer receive reports on waste, misappropriation, lax management or inefficiency within government enterprises as a matter of course. Even ministers may not receive such information;
- (e) Parliament will be less likely to receive reports on whether Commonwealth bodies have broken their own legislation or other laws;
- (f) the Auditor-General bids for a financial statement audit of a government company knowing that he must formally report on the accounts and records audit as well. This extra reporting requirement is not borne by his private sector competitors. Therefore, the Auditor-General bids knowing that his private sector competitors have an instant commercial advantage; and
- (g) government companies which can recommend on selection of their own auditor are unlikely to appoint the Auditor-General if he tendered. The reason is that the Auditor-General is bound by section 63P to report to the minister and to Parliament on a company's financial statements and accounts and records. As pointed out earlier, no similar requirement exists in the Companies Code. In other words, even if the Auditor-General's tender were the lowest for an audit contract with a government company, it would be unlikely that he would be awarded the contract. In this situation, both efficiency and accountability to Parliament are compromised.

8.18 Reduction in the information available to ministers and Parliament from private auditors because of the non-applicability of the dual appointment under the Companies legislation and the Audit Act is significant. The reduction is tempered by the increase in the amount of information which may be provided by instrumentalities to ministers on achievement of their financial targets as outlined in the May 1988 Economic Statement. One viewpoint is that provision of information to ministers on the rate of return on government investment in a government instrumentality makes redundant audit reports to ministers on

accounts and records, (see Chapter 11). Nevertheless, it can be asked whether there is any difference between information provided by auditors and by directors of government companies. Alternatively, does the source of financial information affect the accountability of government instrumentalities?

8.19 In the Committee's view, auditors independent of an instrumentality's management and board of directors are an aid to shareholders whether they support and add to the financial statements provided by management or whether they question these. To severely reduce this source and type of reporting may have no impact on an instrumentality's efficiency, yet it reduces its accountability to Parliament and to the community. It would seem to the Committee that the best way to safeguard both efficiency and accountability is for the Audit Act to continue to apply to government instrumentalities incorporated under the Companies legislation.

## Legality of Behaviour of Government Organisations

8.20 Reduction of government controls on the operation of commercially-oriented Commonwealth bodies and emphasis on bottom line performance will mean that they will become more like their private sector competitors in their operations. In particular, those agencies involved in international trade, whether through equipment purchase, service provision, product sales, or through other avenues, will be under intense pressure to maximise profitability through increasing productivity and reducing costs. This push for a more efficient public sector is desirable. However, there are some consequences which Parliament cannot ignore<sup>6</sup>.

8.21 One consequence is adoption of tax-driven financial strategies by government agencies. The boundary between legitimate tax minimisation and tax-driven financial strategies is not always

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6. The Commonwealth Attorney-General's Companies and Securities Consultative Group on the Corporations Legislation believes that certain kinds of Commonwealth Government organisations can break the law. For this reason, it recommended removal of the 'shield of the crown' for government instrumentalities, at least in respect of takeovers and market offences. Submission No. 21 to the Joint Select Committee on Corporations Legislation, Commonwealth Attorney-General's Companies and Securities Consultative Group, 5 January 1989: Gill, P., "Crown Immunity in Business Law Queried", Australian Financial Review, Thursday, 26 January 1989, p.1.

clear<sup>7</sup>. It is the responsibility of government agencies to stay within the law and the responsibility of ministers to ensure that agencies within their portfolios which are required to pay tax do so. However, a concern with organisational profitability in tight markets will place enormous pressure on those organisations to examine their financing and tax liabilities with great care to see how the latter can be reduced. An undesirable consequence of greater public sector efficiency would be where government agencies were not fulfilling their taxation liabilities.

8.22 This aspect was selected to highlight how the process by which a government agency or corporation with commercial tasks pursued its goals may be as important as achievement of those objectives. The distance of ministers from the daily operation of many statutory authorities and government business enterprises makes it very difficult for them to know about such matters in detail. Therefore, there is a need for Parliament and the public to be reassured of the probity and proprietary nature of the corporate behaviour of these organisations. The external auditor has a role to play in this matter in both his performance and regularity audits, without him being seen as an agent of the Commissioner of Taxation<sup>8</sup>.

8.23 The argument put forward by some government agencies that they should be exempt from the Audit Act is mistaken since it places such little weight on the legitimate concerns of the agencies' owners, who are taxpayers. The latter will be satisfied first if government agencies operate legally and are seen to operate legally. They will be even more at ease if those agencies operate efficiently. Agencies' annual reports to Parliament and consistent profitability are no guarantee of the exemplary corporate behaviour which Parliament has a right to expect. The Auditor-General has an important role in upholding the interests of Parliament and taxpayers in these matters. For that reason, the Committee does not agree with the boards and chief executive officers of some government agencies that the latter should be

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7. 'Don't take us on, is tax chief's warning,' Australian Financial Review, Tuesday, September 20, 1988, p.4: Boucher, T., 'Taxation Law and Administration - Beyond 1988,' ACT Bicentennial Accounting Congress, Canberra, 18 November 1988.
  8. The Auditor-General's May 1983 report to Parliament drew the latter's attention to how Qantas had transferred shares from a Sydney share register to a share register in Darwin so as to attract lower stamp duty costs upon the subsequent sale of those shares: Auditor-General, Report of the Auditor-General upon audits, examinations and inspections under the Audit and other Acts, Parliamentary Paper No 2/1983, AGPS, Canberra, May 1983. Qantas is an example of a Government company which has been able to cut costs through tax effective arrangements such as leverage leasing and debt defeasance: Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 10 October 1988, p. 1402; 'You Own the Airline, Japanese Own the Jumbo' Sydney Morning Herald, 14 July 1988, p.1.

exempt from the Parliamentary scrutiny which the Auditor-General facilitates.

## **Government Business Enterprises in Transport and Communications**

8.24 In October 1987 the Minister for Finance released a White Paper on Commonwealth Statutory Authorities and Government Business Enterprises<sup>9</sup>. The Minister indicated that guidelines in that Paper were a major step in the Commonwealth's overhaul of public sector administration, implementing performance oriented management practices based on devolution of responsibility with appropriate accountability for results. According to the White Paper, the reforms indicated the Government's commitment to achieving the highest levels of operational and financial efficiency in Commonwealth business enterprises. Of relevance to this inquiry was the Guidelines' pronouncement on the accountability and auditing of statutory authorities and government business enterprises, GBES.

8.25 Relevant accountability provisions included the following:

each authority was accountable to Parliament through its minister;

the authority's annual report was the main means for reporting to the minister and to Parliament. In fact, the annual report was the 'centre-piece of its accountability'; and

an authority's activities would normally be monitored by the minister to ensure satisfactory observance of the requirements of the existing charter, the adequacy of that charter, and the general quality of performance, including assurances that the conduct of business by an authority conformed to appropriate public standards of propriety and probity.

8.26 Changes were foreshadowed in Part X1 of the Audit Act 1901, which provides standardised provisions for the financial management of incorporated bodies, by proposing amendments to provisions dealing with estimates, contracts and borrowings.

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9. Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises, A Policy Information Paper issued by the Minister for Finance, Senator the Hon Peter Walsh, October 1987, AGPS, Canberra, 1987.

8.27 No change was indicated or foreshadowed in auditing arrangements. In other words, the White Paper did not express any criticisms of the Auditor-General.

8.28 The Treasurer's Economic Statement of May 1988 included a section titled 'Reform of Commonwealth Business Enterprises', which extended the Policy Guidelines in the above White Paper<sup>10</sup>. The Economic Statement argued that the thrust of the Guidelines in the 1987 White Paper was that the Commonwealth as owner/shareholder would focus on the results achieved by each GBE rather than on the processes involved in managerial decision-making. The concentration was on GBEs in the Transport and Communications portfolio.

8.29 The eight organisations discussed in the White Paper have a strategic role in Australian transport and communications with assets of more than \$20b. At June 1987 the Commonwealth's investment in them was estimated at \$9.4b or \$1 900 for each Australian household. Their strategic importance could be gauged by how, according to the Treasurer's statement, they influenced the nation's overall cost structures.

8.30 Under a 'Removal of Controls' section, the May Economic Statement indicated that:

The current large number of Government controls over day-to-day operations will be virtually all removed or substantially relaxed.

8.31 In addition:

The requirement to use the Commonwealth Auditor-General will be removed, except in the case of Telecom and Australia Post, in reflection of their large non-commercial activities.

8.32 In future, six major transport and communications GBEs will be able to select their own auditor. These organisations are:

- . AUSSAT
- . Australian Airlines
- . Australian National Line, ANL
- . Australian National Railways Commission, AN
- . Overseas Telecommunications Commission, OTC
- . QANTAS.

8.33 The Government has passed legislation to establish

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10. Economic Statement May 1988, op. cit., p. 151.

these organisations as public companies. These companies can now seek appointment of an auditor under the Companies Code.

### The Inquiry

8.34 The inquiry received submissions from three of the six GBEs referred to above. These were:

- . AUSSAT
- . QANTAS
- . Australian National Railways Commission (AN).

8.35 They differed widely on the question of whether the Auditor-General would remain their auditor.

8.36 AUSSAT stated that it was<sup>11</sup>:

...completely satisfied with the performance by the Auditor-General of the duties required in the audit of a company.

8.37 AUSSAT was silent on whether it saw advantages in having a private sector firm as external auditor, and gave no explicit indication of whether it wanted to change auditors. However, the above extract from the response to the Committee's terms of reference indicated satisfaction with the Auditor-General.

8.38 QANTAS indicated that<sup>12</sup>:

Companies operating in a competitive environment will seek suppliers of services, including auditors, on the basis of services provided and cost.

8.39 That is, QANTAS appeared to believe that it should have the discretion to choose between the Auditor-General and private sector audit firms.

8.40 AN complimented the Audit Office's conduct of regularity

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11. AUSSAT Submission to the Inquiry Reform of the Australian Audit Office, 27 July 1988.

12. Qantas Submission to the Inquiry Reform of the Australian Audit Office, 23 August 1988.

audits, but was sceptical about the need for performance audits<sup>13</sup>. The latter were criticised for being costly with AN having no discretion over the audit's scope and costs. A stronger criticism was that performance audits were not usually carried out by private sector organisations. AN claimed that it operated in a competitive environment, and therefore performance audits placed it in an unfair commercial situation since its competitors did not have to bear similar costs. A retort was that neither did those competitors receive the benefits of those audits.

8.41 AN considered that its Act clearly defined its role as a business undertaking and provided for appropriate mechanisms for performance auditing which were more effective than the Audit Office's performance auditing approach. Accordingly, performance auditing was not considered necessary for those agencies such as AN which had modern legislation providing for a high degree of public accountability.

8.42 The Committee found that this was the clearest expression of auditee belief that the introduction of program budgeting had obviated the need for performance auditing of GBEs.

8.43 The Committee noted that the 1988 May Economic Statement provided no justification for the decision to permit six nationally important GBEs in the Transport and Communications Portfolio to select their own auditor. The lack of justification was surprising given the implications of the move. Amendments to the appropriate legislation have been introduced to implement Government policy on this matter.

8.44 Of relevance is the view of the Australian Society of Accountants. In evidence given to the Committee, the Society argued that<sup>14</sup>:

The Society favours the ultimate responsibility for the audit of Government bodies being vested in the Auditor-General with the Auditor-General being empowered to delegate the performance of the audit task to private accounting firms. Such an approach has been working successfully in the Victorian public sector for several years.

8.45 The Committee believes that there is a severe loss in accountability apparently brought about by government auditees choosing their own auditors who will work under the Companies

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13. Australian National Railways Commission Submission to the Inquiry Reform of the Australian Audit Office, 18 August 1988.

14. Australian Society of Accountants Submission to the Inquiry Reform of the Australian Audit Office, 3 June 1988.

Code rather than the Audit Act, especially in the absence of substantive criticism of the AAO's financial and regulatory audits.

8.46 The Committee recommends that:

- . 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.

8.47 However, as with SMAs, GBEs should have the right to request the Auditor-General through their ministers to appoint a private audit firm on contract to the Auditor-General. Ministers may agree or disagree with any such request from a GBE to approach the Auditor-General on their behalf.

8.48 The Committee recommends that:

- . The Auditor-General be reinstated as the external auditor of Government Business Enterprises.

## **Government Companies and Subsidiaries**

8.49 It is not clear what the taxpayer gains from removal of the Auditor-General as external auditor of Government companies and replacement by a private sector auditor who will audit under the Companies Code. A counter argument is that in those cases where the minister appoints a private audit firm as a Government company's external auditor, then the minister is acting on Parliament's behalf. The private sector audit firm will report to the minister and to Parliament via the audit opinion published in the auditee's annual report. In these situations, it can just as readily be said that the executive arm of government is appointing its own auditor.

8.50 Government permission to certain of its companies to select their own auditors suggests that the Government believes that there are efficiency gains without loss in the accountability of these companies to Parliament. This view also points to an unstated Government belief that the Australian Audit Office lags behind the best private practice in the audit of commercial organisations. Recommendations here seek to improve the Audit Office's image and capacity in this regard. The Committee is working towards a better balance of audit efficiency and Parliamentary accountability of all Commonwealth organisations. It is not convinced by the argument that there is no loss in accountability when Government companies are audited by private sector audit firms or partnerships under the Companies Code.

8.51 The Committee recommends that:

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.

8.52 As at the 30 June 1988, the Auditor-General was external auditor of 110 of the 133 identifiable companies in which the Commonwealth had a controlling interest<sup>15</sup>. Some of these companies were subsidiaries. The total number of companies audited by the Auditor-General increased from 69 in 1986 to 133 in 1988<sup>16</sup>.

8.53 Commonwealth authorities or companies which have a controlling interest in subsidiary companies appoint the latter's external auditors. In 1985-86, there were 16 subsidiaries of Commonwealth authorities which were incorporated in Australia and to which the Auditor-General had not been appointed auditor under either the Companies Act or the Audit Act. There were nine subsidiaries of Commonwealth statutory corporations which were incorporated outside Australia and for which the Auditor-General was not appointed auditor. The numbers of directly created Government companies and subsidiary companies of Commonwealth organisations not audited by the Auditor-General have risen in the last few years.

8.54 The consequences of subsidiaries having auditors other than the auditor of the parent company are that the overall situation of a GBE cannot be known with certainty until the reports of all its auditors are available. Even then there can be difficulties in coming to terms with a GBE's accountability.

8.55 A previous Auditor-General gave an example of problems in this area in a 1987 address<sup>17</sup>. A particular enterprise incurs

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15. The 133 total excluded 5 Aboriginal Development Commission companies: Auditor-General, Annual Report, 1987-88 op.cit., Appendix 5.

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

17. J Monaghan, Public Enterprises - Are They Publicly Accountable? An Address to the Government Accountants Committee, New South Wales Division, Australian Society of Accountants, Twilight Seminar, Sydney, 26 March 1987.

costs on behalf of subsidiary companies. In accordance with what has been a fairly common business practice for 'related party transactions' (acknowledged as reasonable by the audit profession) substantial costs incurred by the authority are not passed on to the subsidiary. A result is that there is a substantial window-dressing effect on the subsidiary's financial results, and the arrangement may have been influenced by tax planning considerations. Such window-dressing may be a factor in selling the subsidiary.

8.56 The problem is to determine whether the parent company, statutory authority or GBE acted with commercial acumen or acted inappropriately towards its subsidiary. Coming to grips with the accountability consequences, including limitations on Parliament's capacity to understand the overall financial situation of the Government parent body, is difficult in itself. Certainly the situation becomes more complex when there are different auditors.

8.57 The Senate Standing Committee on Finance and Government Operations recommended in 1982 that all subsidiaries of statutory authorities be subject to audit by the Auditor-General<sup>18</sup>. The Public Accounts Committee agrees with this recommendation with an extension to include subsidiaries of Government companies and GBEs.

8.58 The Committee recommends that:

- . The subsidiaries of all statutory authorities, government owned companies and Government Business Enterprises be subject to audit by the Auditor-General.

8.59 Notwithstanding these recommendations, the Committee is not opposed to the Auditor-General employing private auditors and audit firms on contract to broaden current approaches to audit.

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18. Fifth Report of the Senate Standing Committee on Finance and Government Operations, Statutory Authorities of the Commonwealth, AGPS, Canberra, 1982.

## Chapter 9

### AUDITS ON CONTRACT

9.1 Chapters 7 and 8 stated that the Auditor-General should be maintained or restored as the external auditor of all statutory authorities, statutory marketing authorities, government business enterprises and government companies, and that the Auditor-General should continue to have the authority to recruit private sector auditors as individuals or as partners in firms to audit on his behalf on a contract basis. This chapter explores further the issue of audits being conducted on contract to the Auditor-General. Chapter 9 recommends specific guidelines and considerations relevant to the appointment of a contract auditor should the Auditor-General decide to make such an appointment.

9.2 The decision should be based on the following factors:

the need for an independent audit of the highest standard;

available resources; and

necessity of strengthening the AAO's capacity and professional standing.

9.3 The AAO must strengthen its capacity to undertake regularity and performance audits. This strengthening would not be achieved if all audits were contracted and AAO staff merely read reports provided to them by private sector audit firms. Under those circumstances, professional skills would deteriorate and the Audit Office would become little more than a post box. Previous chapters have argued the case for reinforcing the Audit Office's independence. Independence would have little meaning unless Audit had the expertise and resources to continue to undertake audits of all kinds of government organisations.

9.4 Consequently, private sector audit firms should not monopolise audits of any single category of government organisation, such as government companies, nor should they be permitted to monopolise any single kind of audit, such as financial audits, leaving performance audits to the AAO.

9.5 If audits of government companies and other large commercially oriented government organisations were always allocated by the Auditor-General to large audit firms, then the Audit Office would have enormous difficulty in attracting quality staff. Further, the Audit Office would never be able to offer the breadth of professional experience necessary for accreditation of chartered accountants, (see Chapter 13). Therefore, there are boundaries on what proportion of the Audit Office's work should be contracted out. Of note was the Scottish Audit Office's strategy for maintaining a strong technical capacity. The Scottish Audit Office alternates with private sector auditors as the external auditor of certain government agencies.

9.6 Progress within the AAO on its restructuring and progress on acknowledgement that auditees have interests and needs which can be met by Audit staff without undermining the Auditor-General's responsibilities to Parliament, are additional factors to be taken into account in consideration of what proportion and which Audit Office work should be contracted.

9.7 There are two specific instances where it is appropriate for the Auditor-General to employ agents:

where there is a conflict of interest inherent in the Auditor-General conducting the audit. A current example is of how the Auditor-General has employed an agent to audit the Department of Aboriginal Affairs. The Auditor-General was formerly Secretary of that Department, and there may well have been a conflict of interest if he undertook the audit and was examining programs which he had established or managed; and

where a Commonwealth instrumentality operates in another country which requires a local auditor, such as in Hong Kong.

## Legislative Basis

9.8 Section 11(i) of the Audit Act provides that:

The Auditor-General may...

- (a) appoint a person to inspect, examine and audit any accounts, records or stores which are required by this Act, or by any other Act, to be inspected, examined or audited by the Auditor-General, and to report the results... to the Auditor-General...

and a person so appointed has by virtue of his appointment, power to inspect any accounts, records or stores that are required to be so inspected, examined or audited by the Auditor-General or to inspect the accounts, records or stores specified in the instrument.

9.9 This section gives the Auditor-General the authority to appoint persons to conduct audits on his behalf on a contract basis. Advice from the Attorney-General's Department indicated that these provisions permitted the Auditor-General to appoint members of partnerships to work on his behalf. However, he may not appoint an accounting firm or partnership because at law these are not legal entities. He could, however, in the instrument of appointment after inserting the full names of the partners, add 'trading as ...' and then insert the firm's name<sup>1</sup>. Consequently, the Auditor-General has the legal authority to appoint persons as his agents. Notwithstanding, clarification and simplification of the legislation would be beneficial. Canadian legislation is an example of what may be followed. Section 15(2) of the Auditor-General Act states that:

... the Auditor-General may, within the total dollar limitations established for his office..., contract for professional services.

## Selection of Auditors

9.10 In evidence before the Committee, Mr Ken Dye, the Canadian Auditor-General described how in Canada there had been problems in the appointment of auditors of crown corporations<sup>2</sup>. Mr Dye said that:

Crown corporations do not appoint their auditors. It is done by government in cabinet, and so (for example) the chairman of the post office does not have much choice; he does not know who his next auditors will be. It will be at the whim of cabinet. They usually leave them in for five years, but sometimes they change, and they tend to change on change of government. ....I have strongly held views that accounting firms ought not to contribute to political parties on the basis of expected reward.

...there is a correlation between the strength of the gift and the appointment of audits.

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1. D. Shand to Secretary, JPCPA, 23 September 1988.
  2. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 26 October 1988, p.1629.

9.11 The Canadian Auditor-General noted that this problem had gone away because of changes in the way accounting firms participated politically. It should be stressed that there is no evidence that these problems exist in Australia. The Committee wishes to create a framework for avoiding any such problems in Australia in the future.

9.12 Accounting firms are increasingly being made to tender for audit work<sup>3</sup>. Yet there is unease within the accounting profession that audit tendering may harm audit quality<sup>4, 5</sup>. Such concerns have become major problems for the accountancy profession in the United States.

9.13 Because the Auditor-General will select auditors to act as his agent, he may consider calling for tenders.

9.14 In order to ensure that the best auditor is selected, due weight must be given to the estimated cost of an audit. Selection of an auditor must not be based solely on price considerations.

9.15 The Committee recommends that:

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

## Responsibilities

9.16 Problems experienced by the Victorian Economic Development Corporation, VEDC, have focused attention on difficulties which can be encountered when private sector auditors are contracted for audits of government instrumentalities. VEDC signed a contract with the accounting firm Arthur Young to act as the Corporation's auditors. Mr Fergus Ryan, the person appointed by the Victorian Government to inquiry into certain matters concerning the VEDC, found that there were a number of difficulties in regard to audit. These were<sup>6</sup>:

the boundary between the Victorian Auditor-General's and Arthur Young's audit responsibilities;

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3. B. Simmons, 'The Case for Audit Tenders,' Business Review Weekly, 4 November 1988, p.117.
  4. M. Peers, 'Auditors in uproar over fee discounts,' Australian Financial Review, Wednesday, 17 August 1988, pp. 1-2.
  5. T. Thomas, 'No Merger, But Links to be Stronger,' Business Review Weekly, 16 December 1988, p.89.
  6. Ryan, F., op. cit., p. 54.

lack of specification in VEDC's contract with Arthur Young on the latter's responsibilities, and specifically whether the latter included responsibility for review of all major risk areas of VEDC's activities; and

lack of specification in VEDC's contract with Arthur Young on an appropriate frequency of reporting.

9.17 Any increase in the proportion of audits contracted out by the Auditor-General must occur within guidelines which avoid a repetition of these problems in the Commonwealth sector. Guidelines can be contained in the Auditor-General's engagement letters to auditors<sup>7</sup>.

9.18 The Committee recommends that:

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<sup>8</sup>;

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;

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7. R. Walker to Secretary, JPCPA, 20 February 1989.

8. Commonwealth of Australia, Gazette, 'Notice by Auditor-General Setting Auditing Standards', 7 August 1987.

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.

## Consultancies and Conflicts of Interest

9.19 All major accounting firms provide consultancies on taxation, management practices, and computer systems. Some auditees prefer private sector audit firms as external auditors because of ready access and because of a possibly lower marginal cost of these other services. This was expressed by one Government agency wanting to appoint a private audit firm as follows:

As an audit client, the (Government agency) would have access to regular seminars conducted by the audit firm covering current issues, including indirect taxation and export and research grants. The availability of these seminars would considerably assist staff in their professional development.

9.20 If these benefits accrued to individual staff members the organisation as a whole would gain. The Auditor-General does not offer consultancies in any of these areas. Nor is such consultancy advice readily available from other parts of the Commonwealth sector<sup>9</sup>. So from the perspective of many auditees it is logical to appoint a private audit firm as external auditor.

9.21 Where one part of an audit agency provided a consultancy to a client, for example, on the design of a financial management system, and later another part of the audit agency audited that same system, then the audit agency would be indirectly auditing itself. In those circumstances, the auditor would have a conflict

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9. In future, the DOF's Financial Management and Improvement Branch may offer such advice. Of note, however, is the reluctance of many Budget-dependent agencies to turn to the DOF for advice when they must negotiate with the latter over Budget bids. The Development Consultants group within the Public Service Commission has a limited capacity to organise consultancies on some topics.

of interest and the opinion on the financial statement may be constrained. Audit firms responded to this scenario by pointing out that they constructed a 'Chinese wall' between audit and the consultancy sections of the firm<sup>10</sup>, which meant that those two sections of the accountancy firm did not exchange information about the client likely to reduce the integrity of advice any part of the firm may provide to clients. They argued that this reduced the risk of compromise of the audit opinion.

9.22 A relevant fact is that the importance to accounting firms of income from activities other than auditing has increased in recent years. For instance, for the auditors of the 100 largest listed companies on Australian stock exchanges, the proportion of total fees derived from auditing declined from an average of 79 per cent in 1982 to an average of 72 per cent in 1986<sup>11</sup>. Over the same period, the greatest increase in income was in other fees which increased by 105 per cent compared with a 42 per cent increase in fees from auditing. Companies are free to purchase these services from accounting firms other than their auditors.

9.23 The Committee believes that maximum protection of the audit opinion is necessary where Government agencies are concerned.

9.24 The Committee recommends that:

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.

9.25 This is standard practice in at least one other state, Victoria. This in no way would prevent the auditee from purchasing separately from another firm any of the range of consultancies available<sup>12</sup>.

9.26 The Committee recommends that:

The Auditor-General should not develop other specialities permitting the Audit Office to

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10. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 1 July 1988, p. 850.

11. Craswell, op. cit.

12. Two recent court judgments have fundamentally altered the accepted relationship between independent experts and their corporate clients in the private sector. The Phosphate Co-operative Company of Australia Ltd v Shears and Anon. (No. 3) (1988) 14 ACLR 323; (1988) 6 ACLC 1046. ANZ Nominees Pty Ltd v Wormald International Ltd (1988) 13 ACLR 698; (1988) 6 ACLC 780. Stephen Bartholomeusz, 'Independent expert reports must now be just that', The Age, Friday 28 October 1988, p. 19.

operate as a consultant in fields such as:

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

except where these areas are developed as a result of evolution of the audit task.

9.27 Were the Auditor-General to develop a consultancy arm, resources would be directed from his primary responsibility to audit. Use of computers in financial systems is one area where the AAO has considerable expertise and where the Office has and should continue to provide assistance to auditees. It is an instance of where the Office developed expertise as an ancillary to audit. Consultancies provided as part of the audit function are acceptable but those provided otherwise are not. Judgement must be exercised on the boundary between the two.

9.28 Government agencies are free, in general, to obtain such services from where they choose, which could be within or outside the public sector. It is important that commercially oriented government organisations have the capacity to purchase the best advice on which to make commercial decisions, and they should seek such advice.

9.29 Adoption of the above recommendations will not lead to any reduction in the capacity of these organisations to obtain advice, whether the source of that advice be inside or outside the public sector. However, adoption would give greater weight to the accountability of these organisations than to any efficiency gains arising from the external auditor also providing paid advice on other matters, such as financial management or taxation.

## **Audit Standards**

9.30 U.S. federal agencies contract directly with non-federal auditors, who are mostly certified public accountants, CPAs, to audit many of the \$120 b. a year the Federal Government spends on domestic assistance programs.

9.31 A recent General Accounting Office, GAO, study in the United States surveyed the quality of audits undertaken by CPAs on contract to the Federal Government. It concluded that many

governmental audits did not comply with professional standards<sup>13</sup>. Specifically, the GAO reported that:

CPAs did not satisfactorily comply with standards on 34 per cent of the governmental audits they performed, making audit reports less useful in ensuring that federal funds were used for authorized purposes;

more than half of the unsatisfactory audits had severe standards violations;

CPAs' two problems in performing governmental audits were insufficient audit work, first, in testing compliance with governmental laws and regulations, and second, in evaluating internal accounting controls, including controls over federal expenditures; and

smaller CPA firms had greater difficulties than larger CPA firms in satisfactorily complying with standards.

9.32 No evidence was presented to the Committee to indicate that there were problems in the conduct of audits contracted out by State Auditors-General in Australia. However, this may have been more a reflection of the paucity of analysis of public sector audit than it was of the absence of a problem. Audits contracted out by Commonwealth Auditors-General were so few in number and so select that few problems were encountered there. It is unclear what would happen, however, if there were sudden growth in the numbers of contracted audits at federal level in Australia.

9.33 The Committee recommends that:

The Auditor-General monitor the quality of contracted audits.

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

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13. United States General Accounting Office, Report to the Chairman, Legislation and National Security Subcommittee, Committee on Government Operations, House of Representatives, CPA Audit Quality: Many Governmental Audits Do Not Comply With Professional Standards, USGAO, March 1986.

## Chapter 10

### AUDIT OF SPECIFIC PURPOSE GRANTS TO STATE AND TERRITORY GOVERNMENTS

10.1 Commonwealth Governments of all persuasions make specific purpose grants to the States under section 96 of the Constitution. In regard to audit, the Auditor-General has no effective jurisdiction after the Commonwealth has made a grant to State governments. Commonly, what occurs is that the Commonwealth Government department or agency, as part of its program design, inserts a clause in an agreement with State government agencies requiring the State Auditor-General to audit the use of Commonwealth finance by that State government agency, or by local government or community organisations within the State.

10.2 Approximately \$11b. in Commonwealth payments to the States were made as specific purpose grants to the States and Territories in 1988-89. Information provided to this inquiry by the Department of Finance suggested that audit certificates were required by Commonwealth departments from State and Territory Auditors-General for approximately \$2b. in specific purpose payments. A Department of Finance list of specific purpose programs for which such State or Territory audit certificates were required is in Table 10.1. At time of writing, no information was available from the Department of Finance on audit arrangements for the remaining \$9b. in Commonwealth funds.

10.3 The Chairman of the Commonwealth Grants Commission, Mr Justice Else-Mitchell, has pointed to the major problems of accountability associated with tied grants or specific purpose payments which require a State as the recipient of a grant to comply with conditions prescribed by the Commonwealth on expenditure of the funds granted<sup>1</sup>. This was particularly the case with payments which were not channelled through a State's consolidated revenue fund or some similar budget account.

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1. Else-Mitchell, R., Robson, K., Achieving Financial Accountability in a Federal System, Occasional Paper No. 43, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, 1987.

TABLE 10.1

Section 96 Grants For Which Audit Certificates Are Required From State or Territory Auditors-General<sup>1</sup>

1. Australian Bicentennial Road Development Trust Fund, Department of Transport and Communication.
2. Australian Land Transport (Financial Assistance) Act 1985, Department of Transport and Communication.
3. Bovine Brucellosis and Tuberculosis Eradication Campaign, Department of Primary Industries and Energy.
4. Coal Freight Rate Efficiency Scheme (Payments to NSW).
5. Community Employment Program, Department of Employment, Education and Training.
6. Federal Water Resources Assistance Program, Department of Primary Industries and Energy.
7. Interstate Road Transport Act 1985, Department of Transport and Communication.
8. Joint Commonwealth - State Rehabilitation Centre, Northern Territory, Department of Social Security.
9. Natural Disaster Relief Arrangements, Department of Finance.
10. Local Government (Financial Assistance) Act 1986, Department of Immigration, Local Government and Ethnic Affairs.
11. Petroleum Products Freight Subsidy Scheme, Department of Primary Industries and Energy.
12. Railway Agreement (WA) Act 1961, Department of Transport and Communication.
13. Rural Adjustment Scheme, Department of Primary Industries and Energy.
14. Sugar Industry Assistance, Department of Primary Industries and Energy.
15. Torres Strait Fisheries Program, Department of Primary Industries and Energy.

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1. D. Shand to Secretary, JPCPA, 13 December 1988, Attachment J.

10.4 State Auditors-General drew the Committee's attention to the unexpected increase in workload imposed on them through these programs, and identified several other problems. These problems, which highlighted the confused accountability provisions surrounding section 96 grants, are listed below<sup>2</sup>:

duplication of audit by Commonwealth and State Auditors-General;

State Auditors-General uncertainty over whether their audit certificates should be provided to the Commonwealth Government department funding the program or to the Commonwealth Auditor-General;

State Auditors-General being requested to provide audit certificates outside their normal area of competence or jurisdiction. For instance, the Victorian Auditor-General made the point that he was asked to provide certificates on the effectiveness of grants for rural financing including whether or not particular properties were commercially viable<sup>3</sup>. State Auditors-General were also at various times expected by the Commonwealth to audit the accounts of community organisations and lobby and interest groups, which is a task that they would not normally undertake; and

Commonwealth requests for much more detailed information from State Auditors-General than the latter were accustomed to provide. An example was given by the South Australian Auditor-General who stated that, for a Commonwealth language program for children in a disadvantaged area, the Commonwealth required certification that its grant was spent by teachers in the classroom providing instruction to the particular disadvantaged students eligible for special assistance. Under normal circumstances, the State Auditor-General's responsibilities would have required him to certify only that the education authority received

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2. The United States is another federal political system which has encountered similar problems of the Federal Government needing to know whether its transfer payments to other levels of government were applied as intended by Federal law. The Single Audit Act 1984 was passed by Congress for this purpose. Single Audit Act 1984, Public Law 98-502, October 19 1984, United States Code, Congressional and Administrative News, Vol.2, West Publishing Co, Minnesota, 1984. W Broadus, J Comtois, 'The Single Audit Act: A Needed Reform', Journal of Accounting, April 1985, p.62.
  3. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 2 June 1988, p. 503.

and applied the Commonwealth grant<sup>4</sup>. Another instance was of how the New South Wales Auditor-General was expected to provide the Commonwealth Government with certificates for the salaries of Vice-Chancellors<sup>5</sup>;

lack of uniformity in Federal audit requirements;

the pressure exerted on State accounting systems by requests from Commonwealth departments for more detailed information than they could provide<sup>6</sup>;

interruptions to the planned schedule of work of State audit departments though unexpected and unforeseeable Commonwealth demands for audit certificates; and

inadequate attempts by Commonwealth agencies to communicate the objectives of programs they funded through the States. Thus, State Auditors-General were often not sufficiently informed about the programs and expenditures they were auditing<sup>7</sup>.

10.5 A combination of these factors has led in the past to some audit certificates from State Auditors-General arriving in Canberra as much as 3 or 4 years late. These programs have included the Wage Pause Program and the Federal Water Resources Assistance Program.

10.6 The Chairman of the Commonwealth Grants Commission has drawn attention to the existence of conditions on many specific purpose grants to the States which were not reported to Parliament in a manner which would enable the accountability of expenditure to be examined at a public level. His review of the administration of these grants led him to conclude that<sup>8</sup>:

The various methods...by which the Commonwealth imposes conditions on section 96 grants do nothing to assist the process of accountability...

10.7 A possible reason for continuation of these problems is the overall lack of emphasis on auditing of Federal departments, agencies and programs. This situation should alter from 1988-89 with the requirement that departments prepare financial statements for audit.

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4. Minutes of Evidence, op. cit., 2 June 1988, p. 510.

5. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 21 July 1988, p. 1093.

6. Minutes of Evidence, op. cit., 2 June 1988, p. 502.

7. Ibid., p. 501.

8. Else-Mitchell, R., Commonwealth Payments to the States, Biennial Conference of Public Accounts Committees, Adelaide, July 1985.

10.8 The Department of Finance's awareness of these problems was shown by re-issue of a Finance Direction regarding audit certificates in respect of bodies audited by State Auditors-General. The directive to Commonwealth agencies stated that<sup>9</sup>:

Grants made to bodies which are audited by a State Auditor-General should not be made on the condition that an audit certificate be provided by the State Auditor-General unless special reasons exist and unless the Department of Finance is first consulted as to whether it is appropriate to request such a certificate.

10.9 While the Committee supports the Department of Finance on this matter, it is suspected that additional action is necessary to reduce problems in this area.

10.10 Better tripartite co-operation at Federal level is essential. Draft legislation on specific purpose section 96 grants should be provided to the Department of Finance and the Commonwealth Auditor-General for scrutiny. Particular attention should be given during legislative drafting to the fact that State Auditors-General are not subject to general control or direction by Federal governments.

10.11 The Committee recommends that:

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.

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.

Draft legislation on specific purpose section 96 grants be provided to the Department of

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9. Department of Finance, Finance Directions, 13/17, Department of Finance, Canberra, 1988.

Finance and the Commonwealth Auditor-General for scrutiny.

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.

The Commonwealth Auditor-General explore with State Auditors-General the advantages of joint audits<sup>10</sup>.

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.

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.

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.

10.12 The reality is that audits of section 96 grants to the States are impossible without the co-operation of State Auditors-General. For too long it appears that some Commonwealth agencies have taken the co-operation of State Auditors-General for granted. Also, it is very clear that not all Commonwealth agencies have appreciated the limits to the Commonwealth Auditor-General's powers once grants were made. Much can be done within the Commonwealth sphere of influence to reduce these problems and improve accountability. However, it also appears that State government agencies in receipt of Commonwealth funds have not always been conscious of the implications for their Auditors-General of agreements they sign. This is a matter to which the Committee would like to draw attention but which is beyond its jurisdiction in terms of recommendations.

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10. An example of joint Commonwealth - State audits is the audit of the Albury-Wodonga Development Corporation. Minutes of Evidence, op. cit., 2 June 1988, p. 500.

**PART C**  
**PERFORMANCE AUDITS**

## Chapter 11

### PERFORMANCE AUDITS

#### Origins In The Commonwealth Sector

11.1 Performance audits comprise project and efficiency audits. The Auditor-General has had the authority to undertake project audits since earliest times. Section 54 of the Audit Act defines project audits and gives him that authority as follows:

The Auditor-General may in a report under section 11A or 51, or in any special report which he may at any time think fit to make, recommend any plans and suggestions for the better collection and payment of the public moneys and any improvement in the mode of keeping the public accounts, and generally report upon all matters relating to the public accounts, public moneys and stores, and such plans and suggestions shall be considered and dealt with by the Minister.

11.2 Section 2(4) defines efficiency audits as:

(a) an examination of the functions performed by, and the operations carried on by, the body or person for the purpose of forming an opinion concerning the extent to which those operations are being carried on in an economical and efficient manner; and

(b) an examination of the procedures that are followed by the body or person for reviewing operations carried on by the body or person, and an evaluation of the adequacy of those procedures to enable the body or person to assess the extent to which those operations are being carried on in an economical and efficient manner.

11.3 The Royal Commission on Australian Government Administration, RCAGA, recommended in 1976 that efficiency audits

should be conducted within the Commonwealth sector<sup>1</sup>. Efficiency audits were introduced by the Royal Commission in the following words<sup>2</sup>:

If ... departmental managers are to be given a clearer responsibility for their managerial functions and greater freedom and discretion to perform, then it will be the more important that the quality of their performance should be subject to critical review. The Commission proposes, therefore, that there should be a regular program of efficiency audits in which departmental performance will be assessed. These assessments should be so designed that they would bring before ministers, Cabinet and Parliament both the assessment itself and the data on which it is based. Such a presentation would, at least to some extent, make the assessment open to public examination and comment. It would also clearly establish the primacy of political responsibility for administrative efficiency, including not merely that of the minister and Cabinet but also that of Parliament.

11.4 The Royal Commission's justification for efficiency audits is as valid in 1989 as it was in 1976<sup>3</sup>. First, therefore, the Committee wishes to state its belief in the importance of efficiency audits in maintaining a responsive and effective Commonwealth sector. The Committee has also recognised that there are other avenues, such as program budgeting and evaluation, to improve public service efficiency not adopted ten years ago when efficiency audits were introduced.

11.5 It was argued by the Royal Commission that an authority independent of departments and of Treasury and the Public Service Board was needed for this task. The Department of Finance now has responsibility for the Treasury's previous duty of oversight of departments' forward estimates, and the Public Service Board no longer exists. The Royal Commission decided that the Auditor-General should be given responsibility for efficiency audits and the Government accepted this recommendation. The Royal Commission's recommendations led to the 1979 amendments to the Audit Act which gave the Auditor-General responsibility for their conduct<sup>4</sup>.

11.6 The Auditor-General should continue to have responsibility for efficiency audits. His independence gives him great advantage over other agencies and avoids conflicts of

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1. RCAGA, op. cit., Ch.3.

2. Ibid., p. 46.

3. J Glynn, The Department of Performance Auditing in Australia, ANU, Canberra, 16 September 1987.

4. Audit Act 1901, Part VI, Division 2.

interest which may exist were an agency of the executive arm of government to be given this role. Further, his statutory independence bestows his reports with credibility. Second, the Auditor-General has unique powers of access to the records of Commonwealth bodies which are stronger than the powers of any other office holder. These access powers will become more important as the Auditor-General starts to report on performance indicators. A third reason is that organisational efficiency can be assessed in terms of the efficiency of financial management. The Auditor-General is responsible for financial audits, which are a foundation for reviews of administrative efficiency. This is not to suggest that efficiency audits should only deal with financial issues.

11.7 The Committee recommends that:

- . The Auditor-General continue to have responsibility for efficiency audits.

11.8 Efficiency audits were first reviewed in 1983<sup>5</sup>. On that occasion, an Interdepartmental Committee found that the introduction of efficiency units had been of value. In particular:

efficiency audits provided a valuable addition to the means of scrutiny of the administration available to Parliament;

they had identified administrative efficiencies and inefficiencies;

their presence acted to re-emphasise the importance of efficient and sound administrative practices in the minds of departmental managers; and

they were a catalyst in promoting streamlined and improved management practices in audited departments.

11.9 The Interdepartmental Committee concluded that efficiency audits should be retained but that the benefits would be greater and shortcomings reduced if the following changes were introduced:

they were focused on a well-defined administrative function;

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5. Report of the Inter-Departmental Committee Established To Review The Process of Efficiency Audits, Department of Prime Minister and Cabinet, Department of Finance, Public Service Board, 1983.

they were undertaken quickly so that timely and relevant reports were presented with clearly specified recommendations;

they were concerned only with program efficiency and did not encroach on policy considerations; and

they were followed-up quickly, not only externally by Parliamentary review processes but also by relevant departments.

11.10 The current Public Accounts Committee agrees with those recommendations. However, it was evident to this Committee that further evolution of efficiency audits was desirable. At least three other Parliamentary Committees concluded similarly. For example, the former House of Representatives Expenditure Committee conducted hearings on the efficiency audit process, although a report was not completed because of the dissolution of Parliament. The Expenditure Committee and the current House of Representatives Standing Committee on Finance and Public Administration have reviewed all efficiency audits of the Australian Taxation Office<sup>6</sup>. Of note is that the Senate Standing Committee on Finance and Government Operations has reviewed the entire efficiency scrutiny process<sup>7</sup> (about which more will be said later). However, this PAC report is the first public review of efficiency audits since they were introduced in the 1970s.

11.11 Only a minority of the 52 efficiency audits completed since their introduction in 1979 have been criticised by Parliamentary committees. However, those that have been criticised have been discussed in strong terms. Examples of efficiency audits which have been criticised by Parliamentary committees include:

Australia Post - An Audit Discontinued, September 1986<sup>8</sup>;

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6. A Taxing Problem. Review of Five Auditor-General's Efficiency Audit Reports into the Australian Taxation Office, Report from the House of Representatives Standing Committee on Expenditure, AGPS, Canberra, 1986.  
A Taxing Review. Review of Six Efficiency Audits of the Australian Taxation Office, Report of the House of Representatives Standing Committee on Finance and Public Administration, AGPS, Canberra, 1988.
  7. A Tale of Three Cities. A Review of an Efficiency Audit of the Australian Taxation Office: Taxpayers in Unincorporated Businesses, Report of the House of Representatives Standing Committee on Finance and Public Administration, the Parliament of the Commonwealth of Australia, Canberra, 1988.
  7. Senate Standing Committee on Finance and Government Operations, Review of the Efficiency Scrutiny Program, (forthcoming).
  8. Joint Parliamentary Committee of Public Accounts, Australia Post - An Audit Discontinued, Report 250, AGPS, Canberra, 1986.

Review of Efficiency Audit - Australian Wool Corporation Property Operations, October 1987<sup>9</sup>.

Management of the Main Battle Tank. Who was Outgunned? May 1984<sup>10</sup>; and

An Efficient Organisation, Or An Efficient Audit? Review of the Auditor-General's efficiency audit report into construction project management practised by the Department of Housing and Construction, February 1987<sup>11</sup>.

11.12 Overall, however, there is no doubt that Parliamentary committees eagerly await the arrival of efficiency audit reports.

11.13 With these Parliamentary perspectives in mind, discussion will proceed as follows. Attention will be given to:

major achievements of efficiency audits;  
the distinction between efficiency and project audits;  
the need for new legislation;  
reducing the costs of efficiency audits;  
efficiency audits and the Efficiency Scrutiny Unit process;  
the skills required for performance audits;  
audits of program evaluation plans;  
selection of topics;  
relationships with auditees; and  
reporting to Parliament.

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9. Joint Parliamentary Committee of Public Accounts, Review of Efficiency Audit - Australian Wool Corporation Property Operations, Report 282, AGPS, Canberra, 1987.
  10. Management of the Main Battle Tank. Who Was Outgunned? Report from the House of Representatives Standing Committee on Expenditure, AGPS, Canberra, 1984.
  11. An Efficient Organisation, Or An Efficient Audit? Review of the Auditor-General's efficiency audit report into construction project management practised by the Department of Housing and Construction, Report from the House of Representatives Standing Committee on Expenditure, AGPS, Canberra, 1987.

11.14 Performance audits of statutory authorities, government business enterprises and companies will be discussed in the next Chapter.

## Major Achievements of Efficiency Audits

11.15 Efficiency audits have recommended major improvements and reforms in Commonwealth management and administration in the following areas:

the Australian Tax Office;

Commonwealth administration of nursing home programs;

Australia's bilateral overseas aid program;

collection of excise duties;

administration of the offsets policy;

the Australian Wool Corporation's property operations;

management of the Defence, Science and Technology Organisation;

administration of capital grants to non-government schools; and

the Department of Defence's principles and procedures for the storage and handling of explosives.

11.16 Efficiency audits have also suggested significant cost savings in many areas including:

collection of sales tax by the Australian Taxation Office;

administration of Widows Pensions and Supporting Parents Benefits;

control over manpower and property by the Overseas Telecommunications Commission;

processing and assessment of income tax returns;

management of the Australian Army's principal equipment assets;

the Community Employment Program; and  
administration of public hospitals in the ACT.

11.17 Efficiency audits have also prescribed increased government outlays in order to overcome administrative deficiencies. For example:

purchase of new computers by the Australian Taxation Office;

repair and maintenance of Commonwealth assets;

the Department of Resources and Energy collection of offshore petroleum royalties and excise; and

storage and handling of explosives by the Royal Australian Air Force.

11.18 More detailed information is in Appendix 8.

11.19 One is struck by the range of issues addressed in efficiency audits.

## **Efficiency And Project Audits**

11.20 Efficiency and project audits are part of a broader category called performance audits, which are defined by the International Organisation of Supreme Audit Institutions, INTOSAI, as follows<sup>12</sup>.

Performance audit: an audit of the economy, efficiency and effectiveness with which the audited entity uses its resources in carrying out its responsibilities.

11.21 Table 11.1 provides data on which kinds of government organisations have had efficiency audits. Appendix 7 lists efficiency audits completed by 31 December 1988.

11.22 Efficiency audits have evolved since their introduction. They were initially conducted within a separate division of the AAO. This was later disbanded and staff located within divisions responsible for regularity audits. At first,

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12. INTOSAI Auditing Standards, op. cit.

TABLE 11.1

Efficiency Audits By Type of Auditee, 1979-1988<sup>1</sup>

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Type of Auditee	Number of Efficiency Audits <sup>2</sup>
Departments	23
Departmental Outriders	22
Statutory Authorities	3
Government Business Enterprises	4
Companies	0
Total	52

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1. E Hay to P Nicoll, JPCPA, 24 November 1988.
  2. This list was current to 31 December 1988. Fifty efficiency audits, including 21 of departments, were completed by 30 June 1988.

staff were recruited to work on efficiency audits. This was followed by the expectation that AAO staff should be able to conduct both performance and regularity audits. Now there seems to be some movement within the AAO towards a separate recruitment and career structure for performance, specifically efficiency, audit staff.

11.23 The AAO itself has sought to streamline the efficiency audit process and to reduce costs. One way would be to select smaller, discrete topics for audit. However, this would leave the Audit Office open to challenges that it missed 'the big issues'.

11.24 In turn, efficiency audits have become subsumed within comprehensive audits. The Audit Office refers to comprehensive auditing as auditing which looks to legal compliance and financial regularity as well as to managerial effectiveness and efficiency. These topics may be addressed in a single audit or in separate audits<sup>13</sup>.

11.25 Efficiency audits are conducted under section 48 of the Audit Act, while project audits are executed under section 54 or section 63G<sup>14</sup>.

11.26 Efficiency audits are distinguished from project audits by the former's greater magnitude, complexity and significance of the subject matter<sup>15</sup>. Notwithstanding, some project audits are large and complex. Examples of large project audits include:

Fleet Underway Replenishment Ship - HMAS Success.  
An audit of Department of Defence management of

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13. Australian Audit Office, General Audit Manual, AAO, Canberra, 1988, Chapter 5.

14. Section 48C (1) of Division 2 states that:  
'The Auditor-General may carry out, at such intervals as he thinks fit, an efficiency audit of all or any of the operations -  
(a) of a Department;  
(b) of a public authority of the Commonwealth; or  
(c) of a Commonwealth organisation.  
Section 54 is stated at the commencement of this Chapter.  
Section 63G states that:  
'The Auditor-General shall inspect and audit the accounts and records of financial transactions of the authority and records relating to assets of or in the custody of, the authority, and shall forthwith draw the attention of the appropriate Minister to any irregularity disclosed by the inspection and audit that is, in the opinion of the Auditor-General, of sufficient importance to justify his so doing.'

15. AAO, General Audit Manual, op. cit., 7.15.

the project including definition and design aspects and the contractual and production stages of the project.

Basic Pilot Training Aircraft. A review of the effectiveness of Department of Defence management of the project.

Systems for the Detection of Fraud and Overservicing by Medical Practitioners. Audit examined the procedures adopted by the Department in implementing the surveillance and investigation program.

Direct Credit of Pensions and Allowances to Financial Institutions, Department of Social Security.

11.27 Project audits can arise from financial or regularity audits or they can be small efficiency audits. Their dual origins are complications in their classification.

11.28 In 1986-87 and 1987-88 respectively, the Audit Office allocated 21 per cent and 11 per cent of its resources to project audits. Seven per cent of its resources were for efficiency audits in 1986-87 and 6 per cent in 1987-88<sup>16</sup>. Clearly, the emphasis on resource deployment for performance audits was on project audits, while most auditee attention and criticism was on efficiency audits. As explained in an earlier chapter, the major reduction in resources for project audits experienced between 1986-87 and 1987-88 was due to the Auditor-General's need to find more resources for the increasing amount of regularity audit work. Regularity audits were mandated while project and efficiency audits were conducted at the Auditor-General's discretion.

11.29 For various reasons, project audits tend to be overlooked or even forgotten as a source of Commonwealth sector scrutiny and renewal. The Committee believes that this is regrettable and seeks to draw more attention to them.

11.30 The Committee recommends that:

- . The Auditor-General list project audits in his annual report to Parliament.

11.31 The major difference between the two kinds of performance audit is in the legal requirements surrounding

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16. Chapter 3, Table 3.8.

efficiency audits compared with the relative simplicity of initiation, conduct and reporting of project audits. Efficiency audits are tabled in Parliament in separate volumes and are allocated to Parliamentary committees for scrutiny and possible action.

11.32 The 1979 legal provisions surrounding efficiency audits which cover several pages in the Audit Act, permitted the Auditor-General to conduct his first efficiency audits of certain Federal agencies, statutory authorities and government companies. Thus, for example, after 1979 the Australian Taxation Office was subjected to efficiency audits for the first time. The Audit Act also permitted efficiency audits of government companies, although these audits are conducted only at the request of the minister whose portfolio encompasses the company. No efficiency audits have been conducted of government companies at the behest of ministers. Notwithstanding, it is important that this legislative provision remain because new accountability provisions for government companies outlined in the Government's October 1987 White Paper on 'Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises' emphasise ministerial responsibility.

11.33 Project audits are mentioned alongside regularity audits in the Auditor-General's March and September reports to Parliament on audits completed in the previous period. Efficiency audits are reported separately.

11.34 Both kinds of performance audit have made useful contributions to improved Commonwealth sector efficiency and effectiveness and should continue to do so under any new arrangements.

## New Legislation

11.35 Should the distinction between project and efficiency audits remain? In answering this question, reference was made to the Auditor-General's submission to the Royal Commission on Australian Government Administration<sup>17</sup> and to the Royal Commission's report. Neither document gave much attention to project performance audits, and neither commented on the future of project audits were efficiency audits to be introduced (which, of course, they were). No information was available on the number of project audits completed or resources allocated to project audits before or in 1979, the year in which the Auditor-General was empowered to undertake efficiency audits, or in 1980, the year

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17. Auditor-General, Submission by the Auditor-General to the Royal Commission on Australian Government Administration, An Examination of Proposals for Extending the Role and Activities of the Auditor-General, and of Related Concepts, to Improve Efficiency in All Government Areas, Auditor-General's Office, Canberra, October 1974.

after. Therefore, it was not possible to determine whether more performance audits were completed before the 1979 amendments or whether more resources have been allocated to performance audits since efficiency audits were introduced.

11.36 The Committee believes that, since the major differences between project and efficiency audits are in the size and complexity of the problems addressed, there is less reason than in 1979 (when efficiency audits appeared as radical innovations) for separate efficiency audit legislation.

11.37 The Committee recommends that:

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.

11.38 It should be noted that (2) and (3) in the above recommendation are provisions which apply to regularity audits as well. Therefore, one set of provisions covering (2) and (3) and applying to regularity and performance audits would suffice in any new legislation.

11.39 As discussed elsewhere in this report, there is a need to state unequivocally that the Auditor-General is not entitled to question government policy objectives<sup>18</sup>. Revision of the legislation must take this into account in drafting new clauses on performance audits.

11.40 Canada's Auditor-General Act provides a good example of simply and concisely written audit legislation<sup>19</sup>. Under the heading 'Duties', the Act states that each report of the Auditor-General shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that -

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18. This matter is discussed further in the next chapter.

19. Report of the Auditor-General of Canada to the House of Commons, Fiscal Year Ended 31 March 1987, Appendix A, Auditor-General Act 1977, Minister of Supply and Services, Canada, 1987.

7(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

11.41 Fears have been expressed that a possible consequence of the suggested simplification of performance and regularity auditing legislation would be that, henceforth, the Audit Office must proclaim all project audits as efficiency audits. If this were the case, project audits might become as lengthy, formal and as costly as efficiency audits, thereby further reducing the number of performance audits undertaken. The Committee believes that this is unlikely to happen. What is intended to occur is that project audits would be lifted out of the shadow of efficiency audits, and that both would be accepted more widely as performance audits. From this perspective, the most important difference (but not the only difference) within the category of performance audits would be the size of performance audits.

### **Reducing the Costs of Efficiency Audits**

11.42 Evidence was given that legal requirements governing efficiency audits lengthened their duration<sup>20</sup>. Therefore, the various procedures associated with both sets of performance audits were examined to determine how their execution could be improved. If economies could be made in either kind, then more resources would be free for other audits. Table 11.2 sets out the major steps involved in project and efficiency audits.

11.43 The main differences between the two types of audits were as follows:

in general, efficiency audits varied from 1000 - 5000 hours while project performance audits varied from 100 - 1000 hours;

efficiency audit teams had higher ranking staff than project audit teams. Division and Branch heads were more involved in efficiency audits;

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20. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, Thursday 8 September 1988, p. 1151.

**TABLE 11.2**

**Major Steps in Project and Efficiency Audits**

Project Audits	Efficiency Audits
1. Topics selected on basis of factors listed in (1) below.	1. Topics selected on basis of factors listed in (1) below. An efficiency audit may also develop from a project audit.
2. AAO plan of proposed audit's objectives, resources and methodology.	2. AAO interview with auditee.
3. AAO interview with auditee.	3. Preliminary diagnostic study of proposed subject matter of audit (AAO Auditing Standards, 3.2.3.8.).
4. Audit field work.	4. AAO decision to proceed or not to proceed with an efficiency audit.
5. Progressive AAO - auditee meetings.	5. AAO management plan of proposed efficiency audit's objectives, resources, and methodology.
6. AAO exit interview with auditee.	6. Opening AAO interview with auditee to communicate the audit plan.
7. AAO drafts management letter incorporating comments from exit interview.	7. Audit field work.
8. Auditee response to management letter prepared,	8. Progressive AAO - auditee meetings.
9. AAO report revised if necessary.	9. AAO draft discussion paper in form of the findings and recommendations sections of an <u>Audit Act</u> Section 48F3 report.
10. Audit report completed.	10. Exit interview using as the agenda item the discussion paper in (a) above.
	11. Formal auditee response to draft report.
	12. AAO incorporates auditee's responses in draft report.
	13. Final AAO report to auditee who has 28 days to respond.
	14. AAO considers auditee comments, and revises draft report if necessary.
	15. Audit report tabled in Parliament.
1. A decision on whether a project or efficiency audit will be undertaken depends on the proposed audit subject matter's:	
. materiality;	
. risk and sensitivity; and	
. vulnerability to misuse and incorrectness.	

- . efficiency and project audit teams, respectively, had five and three formal meetings with auditees during audits;
- . efficiency audit reports were generally longer than project audit reports;
- . efficiency audits were longer in duration than project audits; and
- . efficiency audits were more costly than project audits. Exact cost differences were unavailable.

11.44 A number of project and efficiency audits were examined more closely to try and explain these differences. The analysis suggested that:

- . cost differences between the two kinds of audits were due to differences between types of problems addressed. Although there was overlap between the two audits in terms of the size of the financial or organisational phenomena audited, in general, the fact that efficiency audits addressed larger and more complex problems led to their higher cost;
- . auditees were more attentive to the conduct of efficiency audits because of the greater magnitude of the problems addressed. More was at stake with efficiency audits than with project audits. Greater AAO auditee interaction led to more drafts of efficiency audit reports;
- . consequently, efficiency audit reports were longer than project audit reports;
- . the practice of providing separate efficiency audit reports to Parliament with a high probability of examination by a Parliamentary committee gave efficiency audits a higher profile. Section 48F(8) gave him the right to make special reports to Parliament. In comparison, project audit reports were not tabled. The higher profile of efficiency audits bestowed greater formality on their execution and reporting; and
- . efficiency audit legislation could be invoked where an auditee opposed a project audit. For example, a previous Auditor-General invoked his powers under the efficiency audit provisions of the Audit Act in order to undertake comparatively small audits which otherwise would have been labelled as project audits. His authority under the legislation was called upon because the Australian Taxation Office, ATO, would not permit

project audits of certain aspects of the ATO's operation.

11.45 One viewpoint expressed to the Committee was that efficiency audits would take less time if the requirement to have separate efficiency audit reports were removed. As indicated earlier, the practice of publishing separate efficiency audit reports was a decision of successive Auditors-General and not of Parliament. Even if the original practice were revised of including findings of efficiency audits in biannual reports without separate efficiency audit reports, it is doubtful whether the greater length and cost of efficiency audits would be reduced substantially. To reiterate, the reason was that their greater duration and cost were more functions of the greater size and complexity of the problems they addressed than they were of legislative requirements.

## Efficiency Audits and the Efficiency Scrutiny Unit Process

11.46 One way to reduce the time and cost of efficiency audits would be to adopt the modus operandi of the former Efficiency Scrutiny Unit, ESU. The latter was introduced in September 1986 by the Prime Minister as a major initiative in achieving public sector reform. The Unit, which was directed by David Block and staffed by a total of seven people, was disbanded in 1988<sup>21</sup>.

11.47 Distinguishing features of the analytical and recommendatory processes adopted by the ESU were:

- . Prime Ministerial support;
- . leadership by a prestigious individual;
- . tight deadlines, - scrutinies were conducted in ninety days;
- . responsibility for the entire process from selection of topics to methodology, and for advice on recommendations and their implications;

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21. Department of the Prime Minister and Cabinet, Annual Report, 1986-87, AGPS, Canberra, 1987, pp. 35-38.

- . scrutineers were chosen by the departmental secretary in consultation with the Unit. Scrutineers were usually of branch head or section head level, and were seconded from departments and from the private sector. All scrutineers were trained in basic consultancy skills;
- . co-operation with departmental secretaries who nominated topics for scrutinies;
- . the Unit had an advisory and supportive relationship with departments;
- . reports were brief, no longer than ten pages with a two-page executive summary and were prepared for the minister responsible for the department and for the Prime Minister. Reports were not published; and
- . an action plan was prepared for endorsement by the minister, outlining the recommendations, timetable for implementation and, if any recommendations were rejected, the reasons for their rejection. The action plan was submitted to the Unit, which reported to Cabinet's Expenditure Review Committee.

11.48 Major differences between the AAO's efficiency audits and the ESU's work included:

- . different positions on the spectrum between consensus and conflict. The ESU approach did not engender the same suspicion from departmental secretaries as efficiency audits. Notwithstanding, unease often existed within scrutinised agencies because of the knowledge that the ESU had the Prime Minister's support;
- . their sponsorship. The ESU was part of the executive's attempt to improve public sector efficiency. The Auditor-General is less clearly identified with the executive although also very involved in improving public sector efficiency. His independence from the executive places his office in a more adversarial role than with the ESU;
- . their duration. The longer duration of efficiency audits in comparison with the ESU's reviews was due to the greater likelihood of conflict between auditors and auditees, audit legislation, lesser average experience of the auditors in comparison with the scrutineers, and reporting provisions. Scrutinies were probably less costly than audits because of the former's shorter duration. However,

no formal cost comparisons have been undertaken. It is unclear at this stage whether differences in duration of the two kinds of investigation were because of differences in topics addressed; and

. openness of their reports to public readership. Efficiency audit reports are:

- much longer than ESU reports;
- published - while ESU reports were, in general, not published<sup>22</sup>.

11.49 The preceding analysis suggests that the cost of efficiency audits could be reduced if they were shorter in duration. Some legislative change may be necessary to permit this to be achieved (section 48F).

11.50 The Committee recommends that:

- . 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.
- . 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.

## Skills Required for Performance Audits

### Generalists or Specialists

11.51 A number of auditees used their submissions to criticise the AAO for not including specialist staff in audit teams. The views of two government authorities, the Parliament House Construction Authority and the CSIRO, and two departments of state, the Department of Employment, Education and Training and

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22. Most ESU reports have recently become public (some time after they were completed) because of a Senate Committee on Finance and Government Operations inquiry. That inquiry's report will contain a far more detailed appraisal of the ESU process.

the Department of Primary Industry and Energy, are quoted on this issue.

11.52 The Parliament House Construction Authority, PHCA, criticised<sup>23</sup>:

...The system which requires officers to undertake audits of highly specialised and complex projects without providing on the audit team adequately and appropriately qualified and experienced officers.

The primary concern of the Authority was the AAO's apparent inability and even unwillingness, during the audit of the management of the Parliament House Project to assign to the audit team some officers appropriately qualified and experienced in the fields of project and/or construction management, or other related disciplines.

11.53 In reply to criticisms of its efficiency audit of the Parliament House Construction Authority, the Auditor-General asserted that<sup>24</sup>:

The Chairman... has misunderstood the AAO's position regarding the competence requirements for performance auditors. And he refers to 'professional management and technical decisions' of the Authority and its agents in a context that could imply that all their management decisions involve the exercise of technical judgement by specialist professionals.

If indeed that is intended it is as though I were to say that, because the AAO is managed by professional public sector auditors, no one other than (these) could understand its management systems and procedures and management decision-making processes. Were I to say that, I would speak nonsense. The analogy holds good for other specialist organisations.

More specifically, it will be apparent from a reading of the report that the focus of the audit was on the adequacy of the Authority's management decision-making processes, not its technical judgements.

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23. Parliament House Construction Authority Submission, 5 September 1988.

24. E Hay to Secretary, JPCPA, 13 October 1988.

11.54 CSIRO argued that for audits which went beyond simple compliance, staff with experience in the management of government services were essential<sup>25</sup>.

Many of the issues which arise in technically organisations are complex and difficult to understand. It is frequently found that matters explained at the entry conference and on many occasions during the course of the audit are still not understood at the time of the exit conference. Misunderstandings of this magnitude can easily find their way into audit reports and generate excessive effort to resolve.

11.55 The Department of Employment, Education and Training's view was that<sup>26</sup>:

...The AAO does not appear to augment its inventory of skills (e.g. with outside consultants, contractors, or seconded officers from other Commonwealth Departments). This sometimes results in important aspects of systems not receiving adequate scrutiny. This augmentation could provide fresh ideas on auditing Commonwealth programs, expand the skills base of the AAO by providing officers with experience in policy formulation, processes and program administration, and facilitate the training of Public Service employees in the requirements and importance of audit and control mechanisms within Departmental systems.

11.56 The Department of Primary Industries and Energy argued that<sup>27</sup>:

To enable full benefit to be gained from the reviews by the AAO it is considered desirable that their review teams include (where appropriate) consultants that are expert in specified fields. It is considered that a generalist auditor is often unable to comment meaningfully on scientific and business aspects.

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25. CSIRO Submission, 15 August 1988.

26. Department of Employment, Education and Training Submission, 22 August 1988.

27. Department of Primary Industries and Energy Submission, 10 August 1988.

TABLE 11.3

Subject Specialty of AAO Staff<sup>1</sup>

Subject Specialty	Staff Replies <sup>2</sup>	Percentage of Staff Replies
Accounting	365	73.4
Economics	66	13.2
Law	20	5.0
Administration	20	4.0
Computers	51	10.2
Politics/Govt	7	1.4
Other	41	8.2
Total	574	100.0

1. C Monaghan to Secretary, JPCPA, 11 August 1988.
2. 497 or 84.6 per cent of AAO staff responded to the AAO questionnaire. The number and percentage of staff replies were greater than 497 because replies reflected responses of multiply qualified staff.

11.57 On occasion, the Public Accounts Committee has criticised the AAO for lack of expertise in particular areas. For example, the Committee's review of the AAO's efficiency audit of the Australian Wool Corporation's property operations criticised the Audit Office for not presenting a detailed assessment of the relevant property market<sup>28</sup>. The Committee did not believe that the Audit Office had particular expertise in assessing either the market or the economy, and neither did the Committee expect the Audit Office to have such expertise. Therefore, the Committee did not accept that Audit's views were authoritative or based on a professional analysis of the property market.

11.58 Table 11.3 shows the subject specialty of AAO staff. 73.4 per cent were accountancy majors or staff who specialised in accounting in their tertiary studies. Sixty per cent were members of the Australian Society of Accountants or the Institute of Chartered Accountants. The dominance of accounting specialists amongst AAO personnel was a logical reflection of the concentration of AAO effort on financial or regularity audits. There was some evidence to suggest that the professional accountants who are the backbones of the Office's staff preferred regularity to efficiency audits.

11.59 No data were available on the professional experience of AAO staff. Thus, the percentages of staff with experience in program management or financial administration and management were not known. Notwithstanding, it was certainly the perception of many auditees that AAO staff lacked management experience, and that therefore the AAO was limited in its capacity to identify and recommend efficient management practices.

#### The Audit Office Replies

11.60 Previous Auditors-General have replied to these charges in two ways: first, by denying the need to employ subject matter specialists, and second, by employing subject matter specialists. These approaches are examined in turn.

11.61 Classical AAO - auditee interaction over the degree of specialist knowledge necessary for performance audits is contained in the AAO report on the Observations Program of the Bureau of Meteorology<sup>29</sup>. Although the Bureau accepted the major thrust of the audit report and accepted most recommendations:

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28. JPCPA, Australian Wool Corporation, op. cit., p. 14.

29. Report of the Auditor-General upon the Financial Statements prepared by the Minister for Finance for the year ended 30 June 1984. Section 3: Report of the Auditor-General on an Efficiency Audit, Observations Program of the Bureau of Metrology, AGPS, Canberra, 1984.

The Bureau consider(ed)... that the conduct of the audit by a team with no meteorological expertise substantially limited its scope and potential value.

11.62 The Auditor-General replied as follows:

The Audit Office does not concede that one needs to be an expert in meteorology in order to comment validly upon the management of the Bureau of Meteorology. The Office does lay claim to an acceptable level of competence in the auditing of procedures and methods and in measuring whether the taking or avoidance of decisions has followed adequate consideration and has been properly documented. Audit is concerned to determine and report whether these basic requirements have been met, that they have not ... is not to be hidden behind the veils of professional mystique.

11.63 The second course of action has been for the AAO to recruit a specialist consultant for particular audits.

11.64 The AAO gave evidence of consultants being used on four of its 52 efficiency audits, (Appendix 9)<sup>30</sup>:

Commonwealth Administration of Nursing Home Programs, 1983;

Administration of Public Hospitals by the Capital Territory Health Commission, 1983;

Management of the Australian Army's Main Battle Tank, 1983; and

The Australian Taxation Office. A Study of International Profit Shifting, 1987.

11.65 Three of the four instances occurred when there was a separate Efficiency Audit Division in the Audit Office. In the four years since the Efficiency Audit Division was disbanded and the work assigned to other Divisions, an outside consultant was employed on only one occasion.

11.66 The debate focuses on the skills necessary to conduct efficiency audits. Should efficiency audits be conducted only by accountants? Can efficiency audits be conducted by other occupational groups? Should efficiency audit teams include persons with a variety of occupational and analytical skills?

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30. C Monaghan to Secretary, JPCPA, 11 August 1988, Attachment 2.

11.67 A justification of the Royal Commission on Australia Government Administration for arguing that the Australian Audit Office should have responsibility for efficiency audits was the Royal Commission's promotion of value for money audits<sup>31</sup>. The Commission argued strongly that more than working to rule was involved in obtaining value for money. The design of the relevant program, the means adopted for its organisation, the pattern of organisation chosen and relationships established with other agencies all influenced the cost of achieving the purposes of a program. The Auditor-General's financial information on auditees was relevant for efficiency audits. Therefore, it was proposed that the Auditor-General should examine efficiency in organisational matters as well as in financial management. In other words, the most useful organisational studies should 'follow the money trail'.

11.68 The Committee does not dispute this view. Efficiency studies are more than financial analyses since they focus on decision - making and procedures adopted by management in particular policies or programs. That is, by their very nature efficiency audits are interdisciplinary.

11.69 It follows that while efficiency audit teams should employ accountants, they should also employ persons with highly developed analytical skills who are not accountants. These staff may have management skills, with skills in the policy or program subject areas, or they may have demonstrated in other ways that they have mastered how to study organisations and programs and provide proper advice.

11.70 Were efficiency audits to be conducted by teams so qualified, there would be two main advantages, as follows:

the audit team would be better equipped to focus on how the auditee's efficiency could be improved; and

auditees would be more inclined to believe that the efficiency audit (or performance audit) team was properly equipped. It must be conceded that this may have the unintended consequence of raising the degree of conflict surrounding the audit because the auditee would be more convinced that the auditors had the skills to identify problems.

11.71 Both advantages would add to the credibility of efficiency audit reports. The recommendation to broaden the skill base of efficiency audit teams is not meant as a criticism of all AAO efficiency audits. A large majority of these have led to

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31. RCAGA, op. cit., p. 48.

substantial reform either directly as auditees implemented recommendations of audit reports, or indirectly through subsequent inquiries initiated by Parliamentary committees. The recommendation to broaden the skill base of efficiency audit teams is a way of improving the overall impact and acceptance of resultant reports.

11.72 More efficiency audits have been conducted of the Australian Taxation Office than of any other Government agency. Mr Trevor Boucher, the Commissioner of Taxation, in evidence before the Committee, argued that from his experience it was not only helpful but necessary for efficiency audits to be conducted by multi-disciplinary teams<sup>32</sup>.

11.73 National audit offices in Canada, New Zealand, the United Kingdom and the United States all employ more specialists for efficiency or value for money audits than does the Australian Audit Office. Typical of employment trends is the plan by the British National Audit Office to use ten per cent of its resources for value for money audits to employ specialist consultants over the next five years<sup>33</sup>.

11.74 The Committee does not wish to specify what proportion of non-accountants should be employed for efficiency audits. That remains a matter for the Auditor-General's judgement.

11.75 The Committee recommends that:

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.

11.76 This can be done by:

recruiting permanent staff from a wider range of disciplinary backgrounds; and

employing specialist staff on contracts.

11.77 These specialist staff may be recruited from inside or outside the Commonwealth Public Service.

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32. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 21 November 1988, p. 1794.

33. National Audit Office, The National Audit Office Corporate Plan for 1989-90 to 1993-94, NAO, London, 1988.

11.78 The Committee envisages that many Senior Executive Service, SES, staff and senior Administrative Service Officers, ASOs, in other parts of the Commonwealth sector who have management and administrative experience have the skills to work on the AAO's efficiency audits. Presently, such officers are more inclined to remain as administrators than as analysts of other people's management. This is a reflection of the lack of incentives for these staff to broaden their professional experience. However, there are ways to overcome this problem to the benefit of efficiency audits, the Audit Office, auditees and staff.

11.79 Numbers of Senior Executive Staff, SES, have fallen in the last few years, meaning a reduction in promotion opportunities for senior ASO staff in particular. Consequently, very large numbers of these staff will remain where they are for years. This stability has advantages since officers have become ever more familiar with their work, but potential disadvantages are considerable including the stagnation and decreased morale associated with repetition of the same work year after year. It is from awareness of this environment that the Committee recommends that secondment to the Audit Office for a limited period to conduct efficiency audits should be explored as a way of diversifying the experience of SES and ASO staff in the Commonwealth sector, while simultaneously broadening the skill base of efficiency audit teams. It is not necessary for seconded officers to be involved in efficiency audits of their "home" agencies although that could occur. Any attempt by departments and other agencies to solve the problem of locating surplus unattached officers by expecting them to be placed with the Audit Office must be discouraged. Audit would retain the resources and thus the authority to recruit on a temporary basis whomever it thought appropriate. Temporary appointment to the Audit Office to work on efficiency audits can be developed as a prestigious career broadening opportunity as it was for those staff recruited for limited periods by the Efficiency Scrutiny Unit.

11.80 The nature of problems addressed in efficiency audits requires the involvement of AAO's SES staff with field work done by SES or ASO personnel. Any increase in the number of efficiency audits will place more demands on SES staff who are already stretched. The alternative of nominating the senior ASO staff member in charge of field work as the responsible auditor is not desirable since ASO auditors would be auditing decisions made by SES level officers. If AAO SES offices are to continue to be identified as the efficiency auditor, then the number of SES positions in the Audit Office must be reconsidered.

## **Audits of Program Evaluation Plans**

11.81 In 1987 and 1988 Cabinet upheld the importance of program evaluation. The Department of Finance has promoted

program evaluation to assist in its resource allocation recommendations. The quality of program evaluation across the Commonwealth sector is patchy because of a lack of technical expertise and because of fear of the results of systematic assessment.

11.82 An important issue is whether the Auditor-General has the legislative authority to evaluate the merits of policies adopted by departments and other government agencies. This issue arose in Committee Hearings during discussion of efficiency audits. The Auditor-General indicated that he did not believe that he had the legislative right to examine Government policy in any field, nor did he wish to do so.

11.83 The Committee accepts that, in principle, the Auditor-General should not comment on government policy. However, in the Committee's view, if an efficiency audit team discovers that a change in government policy has affected a Commonwealth organisation's efficiency, then the Auditor-General may identify this as a factor.

11.84 Another example where it may be appropriate for the Auditor-General to comment is where restrictions on the availability of personnel as a result of a government decision impede program delivery in an audited agency. This points towards two factors:

the need for efficiency audits to describe and explain public sector inefficiencies. An efficiency audit contributes if it identifies inefficiencies and it is even more valuable if it explains the reasons why these occurred; and

the distinction between commenting on a government's policies in particular programs and commenting on the effects of a government's policies on the agency itself. The former commentary is not appropriate but the latter could be acceptable.

11.85 DOF suspected that the limits of efficiency audits were ambiguous. To overcome this problem, the DOF argued that the efficiency audit role of the Auditor-General should be more explicitly defined, making clear the distinction between the review of administrative effectiveness, which is an Auditor-General responsibility, and review of policy effectiveness, which is the executive's responsibility<sup>34</sup>.

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34. DOF Submission, op. cit., p.3. Such a definition of the Auditor-General's role would require change in the legislation.

11.86 The Audit Office's written submission did not broach this question of the limits of efficiency auditing in regard to improving the effectiveness of the Commonwealth sector. Thus, for instance, the AAO Corporate Plan asserted that the first goal was to improve the economy, efficiency and accountability of the Commonwealth sector<sup>35</sup>. There was no mention in the Plan of any AAO role in improving the effectiveness of public administration. This omission is at odds with some AAO efficiency audit reports which have commented on the appropriateness of auditee measures to determine whether programs have succeeded or failed<sup>36</sup>.

11.87 For example, the AAO drew attention to shortcomings in the success claimed by administrators of the now defunct Community Employment Program, CEP<sup>37</sup>. The CEP utilised more than \$1 billion in Commonwealth funds and was the largest labour market program ever funded by the Commonwealth Government. The audit cast doubt on how satisfactorily the program had achieved its objectives.

11.88 The CEP example dramatised the dangers of program managers being responsible for deriving ways of assessing the success or failure of their programs. The onus for honest reporting places responsibility for program performance where it should be with program managers. However, since there are few kudos for managers reporting a program's limited success or failure, successes are more likely to be found than their opposites. Therefore, there is room for neutral agencies, such as the DOF and the AAO, to comment on managers' evaluation plans. It should be remembered that there is a distinction between auditing and evaluation.

11.89 Section 6 of the National Audit Act in the United Kingdom states that<sup>38</sup>:

The Comptroller and Auditor-General may carry out examinations into the economy, efficiency and effectiveness with which any department, authority or other body to which this section applies has used its resources in discharging its functions.

Sub-section (1) above shall not be construed as entitling the Comptroller and Auditor-General to question the merits of the

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35. Auditor-General, Annual Report 1986-87, op. cit., p.100.

36. For example, Auditor-General, Efficiency Audit Report, Department of Employment and Industrial Relations, Community Employment Program, AGPS, Canberra, 1987.

37. Ibid.

38. National Audit Act 1983, op. cit.

policy objectives of any department, authority or body in respect of which an examination has been carried out.

11.90 The Canadian Audit Act states that the Auditor-General should report whether:

satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

11.91 Adoption of similar provisions in Australian legislation would permit the Australian Audit Office to comment on evaluation planning without commenting on the merits of programs and policies. The DOF has emphasised the importance for agencies of evaluation planning in adoption of a thorough approach to resource allocation<sup>39</sup>. Results of evaluations should be considered in determination of budget priorities.

11.92 Program and policy evaluation is at an early stage in many areas of Federal Government activity, and there is a dearth of qualified personnel able to plan and execute evaluations. Meanwhile, the need for dispassionate scrutiny of evaluation plans and evaluation actions is very great. As indicated earlier, a clearer statement of the Auditor-General's and the Audit Office's roles would reduce the constraints on the Audit Office contributing to a more effective public sector while prohibiting the Audit Office from appraising Government policy. Such an arrangement would provide even greater assurance to Parliament of better management and informed resource deployment within the Commonwealth sector.

11.93 The Committee recommends that:

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

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.

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39. DOF Submission, op. cit., Attachment, p.34.

## Selection of Topics

11.94 Two observations stand out on the question of selection of topics for efficiency audits:

efficiency audits with minimum exception focus on topics within single programs; and

topics are selected after minimum consultation with the legislature and executive.

11.95 The Efficiency Scrutiny Unit illustrated the potentiality of broader studies in its cross-department reviews which included:

computerisation of personnel records;

Fringe Benefits Tax - calculation of liability by departments/agencies;

library services in departments' Canberra offices;

major purchases of ADP equipment;

payment of accounts;

travel; and

processing of accounts.

11.96 Each of these studies was concerned to improve public sector efficiency in a particular area. Savings to taxpayers from consideration and implementation of these reports was considerable. Similar if not greater cost savings in programs could be made if the Australian Audit Office adopted an equally broad approach to topic selection. This may have the unintended benefit of increasing the co-operation of departmental secretaries since they would not feel as singled out and vulnerable. An example of a possible topic for these cross-department or sector-wide reviews is utilisation of program budgeting data. The practice of issuing special reports on service wide topics has also been followed successfully by the Victorian Auditor-General<sup>40</sup>.

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40. For example, the audit of the Victorian Government's use of motor vehicles. Total Victorian Government investment in motor vehicles was \$170m with operating costs of \$63m. Auditor-General of Victoria, Motor Vehicles, Special Report No. 7, Government Printer, Melbourne, 1987.

11.97 Efficiency audits should continue to include topics which focus on single programs within individual departments or other agencies. There is no shortage of suitable topics within individual agencies.

11.98 The Committee recommends that:

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.

11.99 This would permit the Auditor-General to contribute towards improvements in the economy and efficiency of public administration in a broader way.

11.100 The second observation refers to how the Australian Audit Office has limited consultation in its selection of topics. On the one hand, the solitary nature of the Auditor-General's decision-making is an excellent manifestation of his independence. He should continue to make the final decisions. However, it is clear that broader consultation with the executive and legislature has the potential to increase both the level of interest in efficiency audits and their impact. In particular, the Committee was surprised to discover that the Department of Finance made very few suggestions to the Audit Office on suitable topics. The Department of Finance has enormous responsibility for the forward estimates part of the Budgetary process. Its responsibility is exercised in intensive discussions throughout the year with Budget-dependent agencies. Efficiency audit reports were used by the Department of Finance's Supply Divisions in their provision of advice on agencies' forward estimates. However, it was a matter of luck as to whether an efficiency audit report was available to aid difficult decisions. The consequence was a loose articulation and under-utilisation of the efficiency audit process in Budgetary decisions.

11.101 This situation could be improved if the Department of Finance's Supply Divisions, who are responsible for advising on each portfolio's estimates, were expected to make suggestions on topics for efficiency audits. The Auditor-General would be under no obligation to accept Finance's suggestions. However, such prior consultation would reduce allegations that efficiency audits often addressed inconsequential problems. The major advantage of non-binding discussions between the Department of Finance and the Audit Office on selection of efficiency audit topics would be greater usage of efficiency audit reports in the Budgetary process. Under these circumstances, follow-up of efficiency audits by the Department of Finance would be more rapid and thorough than at present.

11.102 The Committee recommends that:

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.

11.103 On occasion, ministers draw to the Auditor-General's attention possible matters for study through efficiency audits. This arrangement should continue. Yet the Auditor-General receives few suggestions from Parliamentary committees on topics for efficiency audits. He would be better advised of Parliament's needs if he received more non-binding suggestions. Chapter 5 discussed this matter at length.

### Relationships With Auditees

11.104 The fact that the Auditor-General's primary obligation is to Parliament, his client, does not mean that he is without obligations to auditees. The question is what are the natures of the latter obligations? Can he provide a service to Parliament and to auditees at the same time? Must auditees' requirements always take second place behind those of Parliament? Is it possible to harmonise the auditing requirements of Parliament and auditees?

11.105 Two extreme answers to these questions were as follows:

1. Parliament is the Auditor-General's client and the Auditor-General is under no obligation to provide any services to auditees; and
2. the primary obligation of the external auditor of any government agency is to the auditee;

11.106 No participant in the debate held to either viewpoint in its extreme form. In general, however, parliamentarians were closer to (1) and auditees were closer to (2). In particular, many government business enterprises and statutory marketing authorities have moved closer to (2) above as a result of legislation establishing them as companies and because of Government initiatives to reduce its controls over their operations<sup>41</sup>.

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41. Reforming Government Business Enterprise, An Address by the Minister For Transport and Communications, Senator Gareth Evans, to the Australian Institute of Management, Canberra, 1 September 1988.

11.107 Successive Auditors-General have interpreted their role as being closer to (1) above. This has contributed to development of an auditing style wherein Audit Office staff have focused on variations in auditees' accounts, records, and financial statements from provisions of the Audit Act and the associated Department of Finance Regulations and Directions. This task has been and will remain critical. However, overall, there is the widespread belief that this focus on variations from legislative requirements has not been matched by a concern with contributing to a solution to auditees' problems. That is, the perception is that fault finding has not been accompanied by advice to auditees.

11.108 An additional contributing factor has been the Audit Office's interpretation of its independence. Traditionally, the Audit Office was reluctant to provide advice and recommendations to auditees because of the belief that, if auditees acted on those recommendations and the Auditor-General subsequently audited the same area, then he would feel inhibited about assessing the situation. Strictly speaking, this may be true. Yet hypothetical advantages arising from creation of an idealised independence must be balanced against the negative consequences of this application of the concept. These negative consequences have often included auditees' frustration with the results of audits, not because the latter were wrong but because, from their points of view, the audits were incomplete.

11.109 Another dimension was that the Audit Office has been reluctant to provide an audit opinion on accounting questions posed by auditees. For example, an auditee may have proposed to record financial transactions in a particular manner in the financial statements, and have telephoned the Audit Office to seek advice on whether this would be acceptable. The common perception has been that Audit Office staff were tardy to respond for fear of compromising independence, and were slow to advise because of the long hierarchy and difficulty in identifying the decision-maker.

11.110 One Government agency seeking a private sector auditor expressed its preferences for a private sector auditor in this manner. It wanted:

Continuing involvement with management in providing timely advice in respect of significant matters arising from the audit, (and) the accounting and financial implications of current and proposed transactions,...

The private sector audit firm provides a high level of senior partner commitment to the client, ensuring speedy response to issues. Generally

management will have the comfort of a 'direct line' to the senior audit partner and this type of communication is vital where completion deadlines are threatened by controversial matters.

11.111 Both the reluctance to provide immediate advice to auditees in advance of preparation of auditees' financial statements, and the reluctance to offer professional advice in audit reports are out of step with modern audit practice. This knowledge is a major factor contributing to the desire of many large and important auditees to replace the Auditor-General with another auditor.

11.112 The Committee believes the Auditor-General's attempt to devolve more responsibility to staff may improve relations with auditees. Under this plan, regional managers would have far more responsibility for the planning and execution of certain audits, and, in some cases, local staff will be more likely to sign audit reports. This will eliminate some levels of review, and give auditees more confidence that the auditors they meet will have more say in preparation of the final audit report. Auditors are more likely to be in the same city as auditees, thereby reducing auditees' criticisms of the difficulty of access to the officers who sign audit reports.

## **Reporting to Parliament**

11.113 The Auditor-General tables four kinds of reports at different times of year:

a report on the financial statements prepared by the Minister for Finance each financial year. This is generally tabled each November;

a report on audits to 30 June each year and a report on audits to 31 December. These reports are tabled in March and September, and encompass the results of regularity audits and project audits of a regularity or performance kind;

efficiency audit reports which are tabled when they become available throughout the year; and

an annual report.

11.114 Separate reporting of efficiency audits is an effective way of drawing to Parliament's attention issues of major importance in public administration. The disadvantage is that the separation of efficiency audit reports from reports on regularity and project audits intensifies fragmentation of knowledge about programs and portfolios. It also complicates the task of priority

setting by the several committees in both Houses of Parliament which have responsibility for studying and reviewing the Auditor-General's reports.

11.115 The Committee recommends that:

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

11.116 Efficiency audit reports would be tabled as separate material supporting the biannual reports. Presently, efficiency audit reports are tabled when they are completed, permitting the Parliament and the public immediate access to the analysis and findings. There is no reason to change this system. Of note is that the first efficiency audits were reported in biannual reports. However, for various reasons, including the need to satisfy the requirements of Parliamentary committees, the practice has developed of publication of separate efficiency audit reports with no mention of them in biannual reports. Of note is that there is no legislative requirement on the Auditor-General to provide separate efficiency audit reports, although the legislation gives him that option (section 48F(8)).

11.117 The requirement to record in biannual reports the major findings of efficiency audits alongside the findings of regularity and project audits would bestow more responsibility on the Auditor-General to identify the most important matters to report while providing Parliament with the information necessary for it to reach its own decision on significant issues.

11.118 It is noteworthy that there have been some steps in this direction since September 1988. Then, the Auditor-General included for the first time in one of his biannual reports an overview which identified audits with good results, auditees which had demonstrated improvements, and audits which required attention. This part of his reports could be developed further.

11.119 Biannual reports to Parliament are divided into sections on:

departments; and  
statutory authorities and companies.

11.120 This reporting division into kinds of auditees has less relevance given the current emphasis in Government policy on re-invigorated ministerial responsibility for statutory authorities and government business enterprises. Government

emphasis on the responsibility of ministers for agencies within their portfolios has never waned. However, the doctrine of ministerial responsibility has been given new life in:

Reform of Commonwealth Primary Industry Statutory Marketing Authorities. A January 1986 White Paper;

Policy Guidelines for Commonwealth Statutory Authorities and Government Business Enterprises. An October 1987 White Paper; and

the Treasurer's May 1988 Economic Statement on Reform of Commonwealth Business Enterprises in the Transport and Communications Portfolio.

11.121 The Committee recommends that:

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