

Chapter 12

EFFICIENCY AUDITS OF STATUTORY AUTHORITIES, STATUTORY MARKETING AUTHORITIES, GOVERNMENT BUSINESS ENTERPRISES AND GOVERNMENT COMPANIES

12.1 Table 11.1 in the previous chapter showed that of the 52 efficiency audits completed by the Audit Office:

- 23 were of departments;
- 22 were of departmental outriders;
- 3 were of statutory authorities (SAs);
- 4 were of government business enterprises (GBEs);
- none were conducted of companies.

12.2 The Royal Commission on Australian Government Administration (RCAGA), proposed that the Auditor-General's concern with the monitoring of efficiency should extend to all agencies which he audited in respect of financial regularity¹. The RCAGA recognised that this would bring under examination some statutory corporations and government companies then outside the scope of Public Service Board and Treasury review. In total, the Royal Commission's proposals meant extending efficiency audits to over 100 agencies operating outside the public account with widely ranging purposes, functions, organisation and management. At that time, the Auditor-General was the external auditor of all statutory authorities with one exception², and the external auditor of almost all government controlled companies. That situation has changed.

12.3 As discussed earlier, 1979 amendments to the Audit Act, formulated with the Royal Commission's recommendations in mind, gave the Auditor-General the authority to undertake efficiency

1. Report of Working Party of Officials on Efficiency Audits, AGPS, Canberra, 1977, p. 24.

2. The Australian Industry Development Corporation.

audits of departments, SAs and GBES. No authority was given to the Auditor-General to conduct efficiency audits of government companies except at the request of ministers (section 48C). Since 1976 when the Royal Commission reported, there has been rapid growth in the numbers of SAs and GBES, and a proliferation of government companies and subsidiaries.

12.4 The Committee believes that the justification for efficiency audits of most statutory authorities, government business enterprises and government companies is the same as for efficiency audits of government departments. The justification is in the need to review the performance of managers and organisations as they are given more functions and discretion where they are not operating in a truly competitive environment. Additional functions and discretion are justified on efficiency grounds. Greater freedom from control by the executive arm of government, no matter what the efficiency gains, does not require a lessening in the accountability of government managers and organisations to Parliament.

12.5 The 1979 amendments upheld these general principles with the exception of efficiency audits of government companies which, as was stated, could be undertaken only with the permission of ministers. Neither the Minister assisting the Prime Minister in Public Service Matters, who gave the Government's response to the Royal Commission's recommendations³, nor the Minister for Finance in introducing the 1979 amendments to the Audit Act⁴, explained why the Auditor-General would not be given the authority to initiate efficiency audits of government companies when he was their external auditor. The Committee considered this anomaly alongside auditees' perceptions of efficiency audits.

Loss of Auditees

12.6 As described in Chapter 7, the Commonwealth Government has given statutory marketing authorities, SMAs, in the Department of Primary Industries and Energy and government business enterprises, GBES, in the Department of Transport and Communications the right to advise on who should be their external auditor. Organisations which take advantage of the legislation remove their decision-making from the Auditor-General's scrutiny. The majority of these SMAs and GBES have maintained the Auditor-General as their external auditor for the present, since, at time of writing, one SMA and one GBE had appointed a private audit firm as their external auditor. An

3. Mr Street, Minister for Employment and Industrial Relations and Minister assisting the Prime Minister in Public Service Matters 'Efficiency Audits, Ministerial Statement,' Hansard, House of Representatives, 7 November 1977, pp. 2965-2966.

4. Mr Robinson, Minister for Finance, Audit Amendment Bill 1978, Second Reading, Hansard, House of Representatives, 12 September 1978, p. 824.

increase in the small number of efficiency audits completed in SMAs and GBES would probably accelerate their appointment of private audit firms as external auditors.

12.7 Table 12.1 identifies efficiency audits in SMAs in the Department of Primary Industries and Energy and GBES in the Department of Transport and Communications. The Table shows that efficiency audits have been conducted in only one of the ten SMAs. Two of the six GBES entitled to appoint private audit firms as external auditors have had efficiency audits. Australia Post and Telecom, both of which are required by the Government to maintain the Auditor-General as external auditor, also have had efficiency audits.

12.8 The Auditor-General is in a bind. If he undertakes more efficiency audits of SMAs and GBES, these may seek his replacement by private audit firms which do not undertake unsolicited efficiency audits. Loss of auditees, especially large and important organisations such as those in Table 11.1, is a blow to any auditor. On the other hand, if the Auditor-General does not undertake efficiency audits of these organisations where he believed he should do so, he would not be fulfilling his statutory responsibilities.

12.9 His dilemma is alleviated partially by the necessity of reducing resources for efficiency audits in order to maintain compulsory regularity audits. Therefore, few new efficiency audits are likely to be pursued in the immediate future of organisations listed in Table 12.1. This 'default solution' means that SMAs and GBES will have less reason for opting for external auditors from the private sector.

12.10 A further 'solution' appears from the Government's policy to establish some of these organisations as companies under the Companies Act. Once established, the Auditor-General can undertake efficiency audits only at a minister's request. No minister has ever requested the Auditor-General to undertake an efficiency audit of a government company.

12.11 Because efficiency audits of government companies can be conducted only at the behest of ministers, an Auditor-General who believed that a company required an efficiency audit must first convince the appropriate minister. Existing legislation permits the Auditor-General to approach ministers on such matters. However, other than for an approach to the Prime Minister to audit the Australian Bicentennial Authority, no data are available on the number of occasions Auditors-General have approached ministers with such requests. Nor are there data on the number of ministerial refusals. All that is known is that there has never been an efficiency audit of a government company. The primary reason could be that ministers, in most cases, would not benefit from having an agency for which they were responsible publicly acknowledged as having possible efficiency problems.

TABLE 12.1

Selected Information on Efficiency Audits in Statutory Marketing Authorities, SMAs, and Government Business Enterprises, GBES, 1979-88

Type of Organisation	Efficiency Audits	External Auditor
SMAS		
Australian Wool Corp	Property Operations, November 1985	Auditor-General
Australian Wheat Board		Private Audit Firm
Australian Meat and Livestock Corp		Auditor-General
Australian Dairy Corp		Auditor-General
Australian Canned Fruits Corp		Auditor-General
Australian Dried Fruits Corp		Auditor-General
Australian Apple and Pear Corp		Auditor-General
Australian Wine and Brandy Corp		Auditor-General
Australian Honey Board		Auditor-General
Australian Tobacco Board		Auditor-General
GBES		
Australian Post	Philatelic Service, May 1988	Auditor-General
Australian Telecommunications Commission	Vehicle Fleet Management, March 1987	Auditor-General
AUSSAT		Auditor-General
Australian Airlines		Private Audit Firm
Australian National Line		Auditor-General
Australian National Railways Commission	Commission Traffic, March 1988	Auditor-General
Overseas Telecommunication Commission	Control over Manpower and Policy, September 1984	Auditor-General
QANTAS		Auditor-General

12.12 Since the rate of creation of government companies appears to be faster than the rate of creation of other kinds of government bodies, an increasing proportion of the Audit Office's auditees will be outside the scope of efficiency audits. The Auditor-General should draw ministers' and Parliament's attention to the difficulties in ensuring proper accountability in such circumstances.

12.13 It is obvious that there are severe constraints on the capacity of efficiency audits to examine the efficiency and effectiveness of commercially oriented government organisations. A relatively small number of efficiency audits has been undertaken in this area and the Auditor-General is not permitted by legislation to initiate efficiency audits of certain categories of these organisations.

12.14 For other categories of commercially oriented organisations, particularly those of strategic importance to the nation's transport and communications systems and other organisations essential for export of Australia's agricultural production, a decision to initiate an efficiency audit may lead to loss of valued auditees. There would be further effects from loss of auditees such as: first, the Department of Finance would then make a corresponding reduction in the Audit Office's resources, and second, the Audit Office's loss of prominent auditees would make it more difficult to attract quality staff. Some project audits have been completed of these organisations.

12.15 The Committee recommends that:

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

12.16 The Committee has recognised elsewhere in this report that the need for an efficiency audit of a company which is subject to a truly competitive environment is far less likely to arise than where such pressures do not apply.

12.17 The Committee further recognises that the Auditor-General's competing priorities will rarely result in efficiency audits being conducted of government companies subject to market forces. However, the Committee believes that the determination of whether an efficiency audit should be conducted should be a matter for the Auditor-General and recommends that the section 48C of the Act be amended accordingly.

12.18 The Committee is rather concerned that the definition of 'eligible incorporated company' is excessively narrow in that it is limited to circumstances where the incorporated company is one over which the Commonwealth is in a position to exercise control. Such a definition excludes a company which is incorporated at the intention of the Commonwealth and which receives the majority of its funding from the Commonwealth but which for some public policy reason has a representative board of directors in which Commonwealth representatives are in a minority. An example is the Australian Bicentenary Authority, ABA, which was incorporated at the behest of the Commonwealth, performed important national functions and which received the majority of its funds from the Commonwealth. The Auditor-General did not have power under the 1979 Amendments to conduct an efficiency audit of the ABA without the permission of the ABA or the Minister.

12.19 The Committee believes that the Audit Act should be amended to ensure that such eligible incorporated companies can be the subject of an efficiency audit at the Auditor-General's discretion.

12.20 The Committee recommends that:

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

Auditee Criticisms of Efficiency Audits

12.21 The inquiry found that GBEs and statutory authorities operating in commercial environments had five major concerns about efficiency audits. Although no efficiency audits have been conducted of government companies in ten years, presumably they would have the same criticisms. These criticisms were also voiced by some departments, although those organisations are not the focus in this part of the discussion.

12.22 A general point is that these complaints are made about efficiency audits rather than project audits. No submission to the inquiry criticised project audits. The previous chapter canvassed some of the possible reasons for this. The five criticisms were as follows:

inadequate skills of audit teams (discussed in previous chapter);

their high cost with inadequate benefits;

redundancy of efficiency audits due to introduction of program budgeting;

lack of confidentiality; and

redundancy due to greater emphasis on managerial responsibility.

12.23 These will be considered in turn. Efficiency audits and commentaries on government policy will also be discussed.

Costs and Benefits

12.24 Some submissions to the inquiry, such as the submission of the Australian National Railways Commission⁵, argued that efficiency audits imposed extra costs which their private sector competitors did not have. The costs were in the large amounts of time devoted to these audits by senior staff. The opportunity costs of this 'lost time' were considerable. When performance, particularly efficiency, audits were considered from a cost-benefit perspective, many auditees also complained that benefits were insufficient to justify costs. Another factor for those organisations which may be subject to efficiency audits was the need to take into account the extent to which the organisations were subject to market forces.

12.25 A complicating factor in interpreting auditees' cost-benefit appraisals of efficiency audits was that these receive Parliamentary attention. As discussed earlier, legislative provisions for the initiation, conduct and reporting of efficiency audits are formal. Reports are to the minister responsible for the audited organisation, to the Minister for Finance, sometimes to the Prime Minister, and always to Parliament. The stakes for auditee management are very high and the consequences of an adverse efficiency audit report unpleasant for management to contemplate. Thus, it was not surprising that auditees were not enamoured of efficiency audits. Auditee questioning of the cost-benefit ratios of efficiency audits may

5. Australian National Railways Commission Submission, 18 August 1988.

have camouflaged these other concerns. This is not to deny that a number of efficiency audits can be criticised for excessive duration and cost with few tangible benefits.

Performance Indicators and Performance Audits

12.26 The introduction of program budgeting with the associated clarification of program and organisational objectives may improve Commonwealth sector efficiency. Certainly the performance indicators which are essential components of program budgeting will sharpen the focus of large numbers of government programs and organisations. They will permit program managers to determine more readily whether their programs are succeeding and, if so, their degree of success or failure. These performance indicators will also be used by the DOF in negotiations with Commonwealth-budgeted organisations over annual appropriations. In fact, the introduction of performance indicators should enhance the negotiating and decision-making capacity of the DOF with all kinds of Commonwealth sector organisations. Instrumentalities which are not Budget-dependent are not required to adopt program budgeting, which increases the importance of the Auditor-General's links with these instrumentalities and with Parliament.

12.27 Bottom-line or rate of return figures suggested for GBEs are one form of performance indicator. The Department of Finance wondered whether efficiency audits were still necessary when a rate of return on government investment in an enterprise was specified⁶.

12.28 The Secretary of that Department determined ultimately that⁷:

It is no good asking for the rate of return on assets if it is incorrectly reported or if it is misleading. We will be very dependent on the auditor in that context.

12.29 Finance could use performance data to determine weak points in government organisations and take appropriate action. Therefore, for that central agency, the introduction of the new approach to budgeting meant that efficiency audits were far less important than previously, and perhaps they were superseded. Few civil service managers have ever liked efficiency audits. The arrival of program budgeting and performance indicators meant that from a managerial viewpoint there was less need than ever

6. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 10 October 1988, p. 1300.

7. Joint Parliamentary Committee of Public Accounts. Minutes of Evidence, Reform of the Australian Audit Office, 10 October 1988, p. 1321.

before for efficiency audits. In other words, there was a form of tacit consensus between the Department of Finance and auditees.

12.30 Wider usage of program budgeting within the Commonwealth sector provides two major advantages to the Audit Office. First, the Office will be able to examine data on performance indicators to assist decision making on which performance audits will be undertaken. Second, since both the DOF and the AAO want to maximise public sector efficiency as measured by performance indicators, the latter's availability may facilitate closer collaboration between these two organisations.

12.31 It has been argued that presentation of performance data in Budget explanatory notes for Budget-dependent agencies and in annual reports for other agencies will improve these bodies' accountability to Parliament. Thus it was surprising to learn that five of the six Senate Estimates Committees which reviewed the proposed expenditure of Budget-dependent agencies for the 1988-89 financial year criticised program budgeting in principle and in practice⁸. From a study of a sample of annual reports, there were very few annual reports of government agencies not Budget-dependent which contained useful performance indicator data in program budgeting format. Consequently, any improvements in accountability arising from the application of program budgeting techniques have not yet been realised.

12.32 The Department of Finance has claimed that these were transitional problems and that performance indicators would 'get better.' The alternative possibility was that continued difficulties in their development pointed to basic flaws in this approach to budgeting.

12.33 The unreliability, inconsistency and unevenness of program budgeting data meant that other means were necessary to assess organisation, programmatic and managerial performance. Efficiency audits are an alternative.

12.34 Even if program budgeting were working well and valid and reliable performance indicators of achievement of program objectives were in place and reported to Parliament, program budgeting would be insufficient to ensure the efficiency of public sector organisations. This was because of the distinction between stipulation of a program objective and knowledge of how to achieve it.

12.35 Specification of objectives will not always be sufficient to ensure a program's success. That this is so is evident from the many programs which have had clearly defined objectives, considered reasonable at the time, but which have had

8. Senate Estimate Committees B, C, D, E, F were critical of program budgeting.

little success or have failed. Every portfolio could produce a list of such programs. Nor should it be considered sufficient to specify a bottom line profit figure or rate of return on government investment for GBEs or companies because the same qualifications apply for these organisations as for programs designed and administered by departments.

12.36 To be more responsive to the market place is fashionable and the idea may have virtue. However, even a casual glance at the market-place reveals immediately that there are large numbers of private companies which collapse. As well, there are large numbers of private companies which operate at low profit levels. Owners and managers of these companies may have very clear ideas of what those companies are established to do and have productivity and profit objectives clearly defined. They may even have corporate plans, but for some reason these companies are not performing adequately. The discipline of the market may take a long time to alter this situation since profitability may stay low⁹.

12.37 Returning to Commonwealth GBEs, the expectation that they should operate at the highest level of efficiency is justifiable. Just as reasonable is the expectation that the relationship between their commercial and social objectives should be known¹⁰. However, neither the Commonwealth Government nor the DOF in particular should be under the delusion that this expectation of high levels of efficiency combined with program budgeting will be sufficient for all GBEs to achieve the desired levels of efficiency and productivity.

12.38 Often, for example, a hard working management may not know how to raise efficiency. The DOF may perceive that GBE or company efficiency is lower than expected but not have the expertise or time to assist it to improve its performance. Because of the strategic importance in the economy of the GBE, statutory authority or company, the Government has a vested interest in raising the organisation's efficiency and in reducing the organisation's chance of not achieving its objectives. In this situation two approaches are open to the organisation and to Government.

a management review; or

a performance audit.

12.39 Both of the above would attempt to identify the reasons for the low performance and could make suggestions about how the

9. Sometimes there is a deus ex machina and the company is subjected to a take-over to 'resolve' the situation.

10. An example of the latter relationship is the expectation of Telecom that it make a profit while subsidising the costs of telephone services to rural areas.

latter could be raised. The difference between the two approaches is that the first may be sponsored by the organisation's management and the second by the organisation's owner, that is, by the Government and ultimately by taxpayers. Both the management review and the performance audit have a role to play in improving performance, although recommendations of both can succeed only if they are accepted by management. The Committee upholds the view that the Commonwealth as the 'owner' of these organisations should exercise its right to have performance audits conducted of GBEs, statutory authorities and companies.

12.40 This discussion can now return to the starting point, which was whether the introduction of program budgeting removed the need for efficiency audits. The Committee's viewpoint on this is no. Performance audits, assuming that they are reliable and valid, are one of the very few mechanisms whereby the reasons for a program or organisation not performing to the level required by its performance indicators can be identified. It is wrong to believe that organisational acceptance of performance indicators means that the organisation knows how to achieve those indicators. Performance audits can help to fill this gap.

Lack of Confidentiality

12.41 Several submissions referred to the need for confidentiality of audit reports in order to avoid the risk of compromising the position of GBEs and SAs operating in markets. Those submissions were, in fact, arguing that the Auditor-General should have greater recourse to section 48F of the Act which states that:

- (5) The Attorney-General may issue to the Auditor-General a certificate certifying that the disclosure of information concerning a specified matter, or the disclosure of the contents of a specified document would be contrary to the public interest...
- 5(e) ...by reason that the disclosure would be prejudicial to the commercial interests of a public authority of the Commonwealth or other body...
- (6) Where information, or the contents of a document, to which a certificate under sub-section (5) applies is disclosed to the Auditor-General in the course of the carrying out of an efficiency audit of operations of a relevant body, the Auditor-General may include any of the information, or any of the contents of the document, in a restricted report of the results of the audit prepared by him, and, if he does so, he shall also prepare and sign a separate report of the results of the audit

that does not include any of the information or any of the contents of the document.

- (7) Where the Auditor-General prepares a restricted report of the results of an efficiency audit of operations of a relevant body, he shall forward copies of the report to the Prime Minister, to the Minister and to the Public Service Board and, if the relevant person in respect of the body is not the Prime Minister or the Minister, he shall also forward a copy of the report to the relevant person in respect of the body.

12.42 Therefore, the Act appears to have ample provisions to safeguard auditees' commercial position without abandoning accountability requirements. The question is whether confidentiality and accountability have been compatible in practice.

12.43 Only one submission stated that an efficiency audit report had revealed commercially valuable information to the auditee's competitors. On closer examination, it appeared that the breach of security occurred because of a misunderstanding between the auditee and the Audit Office.

12.44 Apparently, then, efficiency audits have safeguarded commercially important information while pursuing accountability. Notwithstanding, fear of loss of commercial advantage as a result of an Auditor-General's report remained strong with some auditees. Inadequate data were available to show how successive Auditors-General had coped with this auditee unease. One theory was that Auditors-General had set aside auditees' fears and pursued efficiency audits regardless of the consequences. Little evidence was found to support this view. Another theory was that successive Auditors-General had responded to auditee unease by restricting the number of audits of commercially oriented government organisations and by selecting topics not central to those organisations' operations. The fact that there were only four efficiency audits of GBEs in ten years, and one audit of commercially oriented statutory authorities¹¹, pointed towards the legitimacy of this view.

12.45 The inquiry considered whether efficiency audit reports of commercially oriented government organisations should be published. The argument in favour was that publication opened their administrative efficiency and effectiveness to public and Parliamentary scrutiny. The potential impact of perceived unfavourable audit findings was considerable on such matters as credit ratings and market share in a climate where market pressures were finely balanced and where competitive advantages could be quickly eroded. Therefore, there may be instances where

11. The Australian Wool Corporation.

full reporting of audit reviews to the whole Parliament may not be desirable. A powerful argument against publication was that the latter placed certain kinds of government organisations at a commercial disadvantage compared with their competitors who were not subject to such scrutiny. These are repeats of arguments surrounding whether these organisations should be subject to efficiency audits at all. We have seen that the consequence of this game with three players - Parliament, the Auditor-General, and auditees, is that very few efficiency audits have been conducted of these organisations in the last decade. Unless action is taken, efficiency audits will remain few in number and may decline even further.

12.46 The Audit Mandate Chapter recommended that the Auditor-General be maintained or restored as the external auditor of all SAs, SMAs, GBEs and government companies. Acceptance of this recommendation will give the Auditor-General the security necessary to tackle more efficiency audits of organisations in this important sector without fear of losing auditees. While acceptance of this recommendation would be an important step, it would do little to alleviate auditees' suspicions of efficiency audits. It is not a bad thing for auditees to be wary of these. However, the defensive mode which auditees adopt is not conducive to acceptance of audit findings.

12.47 The Committee recommends that:

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

12.48 The objective would be to explore the implications for the selection of audit topics, and to observe whether there were any beneficial changes to relations between the Auditor-General and the auditee favourable to implementation of audit recommendations. This trial approach to audit reporting would maintain the auditee's accountability to Parliament.

Efficiency Audits and 'Let the Managers Manage'

12.49 There were two viewpoints put to the Committee on the role of audit, particularly efficiency audit, when managers were given more responsibility. The first view was of Mr John Nethercote, Deputy President of the ACT Division of the Royal

Australian Institute of Public Administration¹², who claimed that:

It would be quite unwise to assume that, as a matter of course, managerial autonomy invariably leads to efficiency: this is not necessarily so. It can easily lead to complacency, backwaters and fiefdoms.

12.50 Audit, as a means of ensuring accountability, had a role in exposing these undesirable consequences of managerial autonomy.

12.51 The second view was put by Mr David Block, who argued that stronger emphasis on managerial responsibility with greater discretion for public service managers meant that where organisational and administrative problems were so severe that audits were necessary, then it was time to replace management. Efficiency audits were last resort weapons that should not be necessary. Auditors should not be able to tell managers how to do their jobs¹³.

12.52 Greater discretion for civil service managers may be desirable. However, it was constrained by the doctrine of ministerial responsibility for activities of the portfolio. The relationship between ministerial responsibility and managerial discretion was not chartered in evidence before the Committee. Therefore, there was uncertainty about the limits of the 'let the managers manage' notion.

12.53 Civil service managers were accountable to the chief executive officers of their organisations. In turn, chief executive officers were accountable to their ministers. Therefore, it was argued before the Committee that an emphasis on managerial responsibility had not weakened the accountability of either the civil service or ministers to Parliament.

12.54 The doctrine of ministerial responsibility remains fundamental to the Australian system of government. However, there is a danger that its upholding will promote the delusion that ministers are aware of all the strengths and shortcomings of agencies within their portfolios. It is desirable to hope for ministerial omniscience, but in practice it is unrealistic. Furthermore, it may not be in the interests of a departmental secretary, chief executive officer of a government corporation or other agency, or of a minister to have it be known that there is an under-performing agency or program.

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12. J. Nethercote, Public Auditing in Australian Government Administration. Memorandum on Some Machinery of Government Aspects, Royal Australian Institute of Public Administration, ACT Division, Canberra, 1988.
 13. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 21 November 1988, D. Block.

12.55 Consequently, the accountability connection between the line manager, the departmental secretary and the minister is not flawless in the modern public service. If it were, one argument is that the accountability of managers was best pursued by Parliament keeping ministers 'up to the mark'. This argument would mean that Parliament would have no data on individual portfolios other than that provided by ministers. In other words, outside the Senate Estimates Committee process, managers would be accountable to Parliament indirectly. The Committee rejects this view and upholds the need for line managers, departmental secretaries and chief executive officers to be both accountable to their ministers and directly accountable to Parliament. Efficiency audits are one way to maintain the direct accountability of public service managers to Parliament.

12.56 More efficiency audits have been conducted of the Australian Taxation Office and the Department of Defence than of any other Commonwealth organisations. Notwithstanding, it was observed that in evidence before the inquiry that the Commissioner of Taxation and the Secretary of the Department of Defence supported the continuation of efficiency audits¹⁴.

12.57 The Commissioner for Taxation stated that:

...it would have to be true that external scrutiny of the Tax Office by...the Audit Office was a pressure point on us to perform or improve.

We were being put under the spotlight... and that, having happened, it was necessary to respond.

I guess that that series of reports (on the Tax Office) was one of the pressure points, one of the catalysts for change and improvement within the Office.

12.58 After the Australian Taxation Office, the Department of Defence had the next largest number of efficiency audits. Mr Tony Ayres, the Secretary of the Department of Defence, said in regard to these efficiency audits.

We are the third biggest spender...within the Commonwealth departments and if we had less than (seven efficiency audits) I think the taxpayer would have something to complain about. In other words, we have got to be prepared...to stand up and justify what we are doing.

14. Minutes of Evidence, op. cit., 21 November 1988, pp. 1778: 10 October 1988, p. 1356.

12.59 Similar political systems have experimented with devolution of administrative authority and had uneven success. In Canada, for example, devolution of greater financial authority to public service managers took place after the report of a Royal Commission on government organisation¹⁵. Fourteen years later, the Canadian Auditor-General reviewed the situation and concluded that Parliament and the Government were losing control of public finance¹⁶. Subsequently, the Auditor-General was given a stronger role in relation to departments in order to strengthen financial procedures and information systems¹⁷.

12.60 The Public Accounts Committee supports the principle of further devolution of authority to public service managers. However, it believes that a more balanced approach to the strengths and weaknesses of this principle is overdue.

Efficiency Audits and Commentaries on Government Policy

12.61 There is consensus on the need for the audit mandate to be restricted so as to avoid the auditor commenting on Government policy. However, should the Auditor-General be barred from commenting on the policies of Government agencies which determine their own agendas? These agencies include SAs, GBES and incorporated companies.

12.62 A prior question is whether the doctrine of ministerial responsibility outlined in Government White Papers means that such agencies necessarily reflect Government policy. If the answer is yes, then the Auditor-General should not comment on their policies. Of note is how a recent White Paper indicated that the

15. The Royal Commission on Government Organisation, Volume 1, Management of the Public Service, the Queen's Printer, Ottawa, 1962.

16. In 1976 the Auditor-General stated that:

'I am deeply concerned that Parliament - and indeed the Government - has lost, or is close to losing, effective control of the public purse'

The irony was that he suspected that this situation had come about because certain key recommendations on financial management and control made by the Royal Commission were not implemented.

Report of the Auditor-General of Canada to the House of Commons for the Fiscal Year ended March 31 1976, Minister of Supply and Services, Ottawa, 1976, para 2.1

17. Report of the Auditor-General of Canada to the House of Commons, Fiscal Year ended 31 March 1987, Minister of Supply and Services, Ottawa, 1987, para. 1.8.

responsible minister can suggest to the enterprise board that a preferred corporate strategy be reconsidered to better reflect Government policies¹⁸. This is not quite the same as a ministerial request of a Government enterprise to alter its plans and priorities, although obviously that possibility exists and will continue to do so. Therefore, there is a 'grey area' wherein statutory authorities and government enterprises can be expected to follow Government policy but may not automatically do so. A further factor is that Government does not have policies on many areas of these agencies' operations. Thus, the search for principles on which a platform can be built to stop the Auditor-General examining the effectiveness of policies of statutory authorities, especially those commercially oriented, and government business enterprises and companies will not be fully effective if the only principle is that the Auditor-General should not criticise Government policy. It is not obvious what other principles can be used to support the view that the achievement or effectiveness of these organisations' policies should not be examined by the Auditor-General.

12.63 The PAC's 1987 review of the efficiency audit of the Australian Wool Corporation's property operations also drew attention to this area¹⁹. In that report, the Committee noted how the distinction between 'program efficiency' and 'policy' may be difficult to maintain in audits of commercial enterprises. This was because government business enterprises and statutory marketing authorities unlike government departments, were not primarily involved in administering or implementing predetermined government policy but rather were independent, self-managing business setting their own commercial and investment policies within the framework of their legislative guidelines. (This repeats the point made previously in this discussion.)

12.64 Other jurisdictions are concerned about similar issues. A notable recent statement on these matters was the Report of the New South Wales Commission of Audit. One thrust of that report was to improve public sector efficiency, another concern was with accountability. The Commission recommended that in addition to annual reviews of SAs, full strategic audits should be done every five years with input from the private sector. This five year review cycle is similar in principle to the AAO's preferred audit cycle²⁰. The Commission of Audit recommended that these audits should focus on²¹:

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

19. JPCPA, Australian Wool Corporation, op.cit.

20. In 1983 when comprehensive auditing was introduced, a three year audit cycle was adopted by the AAO. Due to resource shortages, that cycle has never been achieved: AAO Submission, op. cit., Chapter 4.

21. New South Wales Commission of Audit, op. cit., p. 24.

financial performance as measured by rate of return on assets and other measures;

the adequacy of performance indicators;

the measurement of performance against targets;

comparison with bodies in similar industries, both local and overseas;

operational practices;

the adequacy of liability provisions;

the overall condition of the organisation's assets; and

the effectiveness of the maintenance program.

12.65 Another example is from Canada where 1984 amendments to the Financial Administration Act called for special examinations to be carried out of all parent Crown corporations scheduled under the Act, and of their wholly-owned subsidiaries, at least once every five years²².

12.66 The PAC's view is that efficiency audits should concentrate on issues of efficient and effective management. Policies of statutory authorities and government business enterprises should not be the direct focus of efficiency audits. However, attention may be drawn to their implications in the study of efficient and effective management. This is a less strict separation of policy effectiveness questions from other matters than is required in efficiency audits of government departments where government policy is more obvious and encompassing. Audits of SAs, SMAs, GBEs, and government companies can examine policies of those organisations by reviewing, for example, whether these were achieved. Essentially the focus of efficiency audits is a matter for the Auditor-General's judgement. In the conduct of efficiency audits in these organisations, the Auditor-General should not feel constrained if efficiency audit reports comment on auditees' policies. However, to emphasise, a commentary or analysis on government policies in ministerial departments will remain beyond the Auditor-General's charter.

12.67 The Committee reaffirms that the recommendation of its review of the efficiency audit of the Australian Wool Corporation's property operations that a details review of efficiency auditing guidelines for government business enterprises should be undertaken. This review should be undertaken by the Auditor-General who should develop new guidelines. In addition,

22. Office of the Auditor-General of Canada, A Framework for the Conduct of Special Examinations in Crown Corporations, Office of the Auditor-General of Canada, Ottawa, 1987.

the review should develop new guidelines for efficiency audits of statutory authorities, statutory marketing authorities, and government companies, and it should involve representatives of those organisations and the Department of Finance. The review would benefit Parliament, the Auditor-General and auditees.

12.68 The Committee recommends that:

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

PART D
SELECTED ISSUES

Chapter 13

THE IMPLEMENTATION GAME

13.1 What happens to the Auditor-General's reports after they are tabled in Parliament? Are findings acted upon?

13.2 By drawing matters which he considers important to Parliament's and therefore to the public's attention, the Auditor-General can exert enormous pressure on audited organisations to modify their behaviour. Notwithstanding, the Auditor-General does not have the formal authority to compel any audited organisation to change its behaviour.

13.3 There are a large number of matters raised in any single audit report and often there are many associated recommendations. Therefore as expected, some issues raised by the Auditor-General receive more Parliamentary, media and public attention than others. The corollary is that it is very easy for many important issues and recommendations to be overlooked in public and political arenas. Even in the unlikely event of consensus between all interested parties on the most important audit findings, it is high improbable that all of these would receive adequate Parliamentary and public coverage. Consequently, mechanisms are necessary to ensure that all audit recommendations are considered seriously by auditees.

13.4 It is acceptable for an auditee not to implement audit recommendations in some circumstances. An extreme case, for example, would be where an audited program no longer existed. Another instance would be where audit recommendations were outdated by large-scale change in an organisation or program. Therefore, the proportion of audit recommendations implemented can be a misleading indicator of audit success.

13.5 The questions at the start of this Chapter will be answered by referring to the roles of auditees, Parliamentary committees, the Department of Finance and the Auditor-General in the process of implementation of audit findings. First, however, an overview is necessary.

Audit Reports and Pontius Pilate

13.6 Especially in regard to efficiency audits, once audit findings were clear:

- . Parliament committees said that follow-up was an Executive Government responsibility;

- the Department of Finance disclaimed the major responsibility to ensure that audit findings were acted upon;

- the AAO said that it was not its responsibility to follow-up audit findings. That was the responsibility of Executive Government;

- auditees may have promised to consider audit findings or they could be ignored.

13.7 For each party, implementation and monitoring of implementation of audit findings was someone else's responsibility. The Committee labelled this 'the Pontius Pilate' approach to audit follow-up.

Auditees

13.8 Auditees are not obliged to act upon any audit findings, although they are expected to give them serious consideration. Often, likely recommendations are considered by auditees during audits. Auditee financial or organisational behaviour may alter before the audit report is finished thus resolving differences between auditor and auditee or alleviating the auditor's concerns. Alternatively, differences between auditor and auditee may widen and harden, and audit findings rejected before they are made. These circumstances are not favourable for implementation of audit recommendations after the report to Parliament.

13.9 From a Parliamentary and from a Department of Finance perspective, conflict between auditor and auditee may be perceived. A Parliamentary committee, or, in rare cases, Parliament itself may step in to resolve the conflict, possibly through the auspices of the responsible minister; or the Department of Finance which may have the authority to recommend to Government on the auditee's appropriation, may agree or disagree with audit findings. If the Department of Finance has budgetary authority over the audited organisation, agrees with

audit findings and the latter are seen as important, then in most cases the auditee will have few other options but to implement audit recommendations.

13.10 Parliamentary committees and the Department of Finance can assess the importance of audit findings and whether they agree or disagree with audit recommendations. If neither the Department of Finance nor any Parliamentary committee believes that audit findings are important or if both reject audit recommendations then it is optional for the auditee to act upon audit findings. There are no data available to show what proportion of these 'optional' recommendations lead to change in auditees' financial or other management.

13.11 An auditee may accept audit recommendations and decide to act upon them. A statement in such terms removes pressure on the auditee from Parliament and the Department of Finance. Yet it is easy for implementation action to slip once an auditee has decided to accept audit recommendations. For this reason, the House of Representatives Standing Committee on Transport, Communications and Infrastructure recently affirmed that¹:

Where an auditee accepts the proposals for change made by the Auditor-General in an efficiency audit report, the auditee should provide the relevant Parliamentary committee with a timetable for implementation at the commencement of the Parliamentary inquiry.

13.12 The Public Accounts Committee supports and extends this recommendation and will expect such audit report implementation timetables from auditees at the commencement of future Public Accounts Committee reviews of all regularity and performance audits.

13.13 The Committee recommends that:

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

1. Efficiency Audit Review: Australian National's Commission Traffic, Report from the House of Representatives Standing Committee on Transport, Communications and Infrastructure, AGPS, Canberra, 1988.

13.14 In accordance with arrangements established in 1980 and confirmed by the Prime Minister in March 1984, all ministers are required to furnish returns to the Minister for Finance at three monthly intervals outlining action taken or to be taken by departments and authorities within their portfolios to correct matters which the Auditor-General has adversely commented on in his reports.

13.15 The minister rather than the secretary of the department or the chief executive officer of a portfolio agency reports to the Minister for Finance. This emphasis on ministerial accountability for his or her portfolio's response to the Auditor-General's reports is a powerful strategy and should continue.

13.16 Where the Public Accounts Committee releases a review of an efficiency audit report, the auditee must contribute to a response in a Finance Minute. This will be described later when the Public Accounts Committee's involvement with audit reports is discussed.

13.17 Guidelines introduced by the Prime Minister in November 1987 and approved by the Public Accounts Committee required departmental annual reports to contain²:

information regarding any reviews by the Auditor-General or Parliamentary committees which directly affect the department showing recommendations arising from such reviews and the action taken to address them.

13.18 It is a requirement of the Public Service Act 1922 that departmental secretaries prepare annual reports in accordance with the guidelines. In May 1988 the Committee wrote to all departmental secretaries stating that in future the Committee would monitor annual reports for compliance with this and other relevant guidelines.

13.19 An analysis of all 1987-88 departmental annual reports tabled during the 1988 Budget sittings showed that the majority of departments had not complied with this particular guideline as it related to audit reports. Only one-third of reports contained adequate information on results of audits and action taken. The Committee was most disturbed to find that several reports appeared to disregard this guideline completely or made a perfunctory reference and directed readers to other, not always public, sources for additional information. The Committee intends to continue its monitoring of this matter.

2. Hansard, 17 November 1987, p. 2163.

13.20 Notwithstanding difficulties in the implementation of guidelines for departmental annual reports, guidelines for preparation of annual reports by statutory authorities do not contain any similar requirements³.

13.21 The Committee recommends that:

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

13.22 An exception may be necessary for confidential audit reports.

Parliamentary Committees

13.23 Section 8 of the Public Accounts Committee Act 1951 states as follows:

13.24 The duties of the Committee are:

- (a) to examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- (b) to report to both Houses of the Parliament, with such comment as it thinks fit. Any items or matters ... to which the Committee is of the opinion that the attention of the Parliament should be directed.

13.25 As a result of this legislation the Public Accounts Committee examines more reports of the Auditor-General than any other Parliamentary committee. The Public Accounts Committee is responsible for examining the following categories of Auditor-General's reports:

3. Hansard, 11 November 1982, p.2261.

reports on financial statements prepared by the Minister for Finance;

biannual reports on regularity and project audits;
the Auditor-General's annual report; and
various efficiency audit reports.

13.26 Importantly, there are several other Parliamentary committees with major responsibility for reviewing efficiency audit reports, including:

Finance and Public Administration;
Transport, Communications and Infrastructure; and
Publications.

13.27 These committees are responsible for monitoring the implementation of audit findings: implementation of the latter is a responsibility of auditees. Appendix 10 lists the Parliamentary committees with responsibility for examining the eight efficiency audit reports released in 1987-88. Appendix 11 lists efficiency audit reports which have not been reviewed by Parliamentary committees since 1979. Forty five of the 50 efficiency audit reports tabled by 30 June 1987 were reviewed or are in the process of being reviewed by Parliamentary committees.

13.28 When reviewing efficiency audits, committees may examine the substance of audit reports as well as the manner in which efficiency audits were conducted. Examples of where the substance and methodology of efficiency audit reports were studied by Parliamentary committees are:

the review of the Auditor-General's efficiency audit report into construction project management practised by the Department of Housing and Construction. The report was prepared by the House of Representatives Standing Committee on Expenditure⁴; and

the review of the efficiency audit of Australian National's Commission Traffic undertaken by the House of Representatives Standing Committee on Transport, Communications and Infrastructure⁵.

4. An Efficient Organisation, Or, An Efficient Audit? op. cit.

5. Efficiency Audit Review: Australian National's Commission Traffic, op. cit.

13.29 Customarily, Parliamentary committees table separate reports on their reviews of efficiency audits. These reports indicate whether the committee agrees with audit findings and whether it believes the auditee should respond to the latter. The responsible minister must provide a response in Parliament within three months of the committee report's tabling. This arrangement is for committees other than the Public Accounts Committee. The leader of the House may also make a consolidated response on behalf of the Government to Parliamentary committee reports.

13.30 With the Public Accounts Committee there is a system known as the Finance Minute. Once the Public Accounts Committee completes a review of an efficiency audit report, the PAC report is sent to the Minister for Finance. The Department of Finance pursues matters raised in the PAC report with the original auditee. At an appropriate time, the Minister for Finance replies to the PAC report with responses to each PAC recommendation. These responses outline what the relevant minister proposes to do and not necessarily what he or she has done. The time or delay involved in this process sometimes has been of concern to the PAC. Further interaction between the PAC, the Minister for Finance and the original auditee can follow depending on judgements the importance of issues. This Finance Minute system places the onus on the Department of Finance, particularly on its Supply Divisions, for pursuing those Australian Audit Office recommendations not implemented by auditees yet determined by the Public Accounts Committee as being of most importance.

13.31 In the United Kingdom, departmental secretaries and chief executive officers of government instrumentalities attend each meeting of the Public Accounts Committee when audit reports on their particular agency are being discussed. This system is highly important in the United Kingdom for maintaining the accountability to Parliament of senior public sector management. The Australian Public Accounts Committee is moving to adopt a similar system.

Department of Finance

13.32 The Department of Finance has authority over Commonwealth agencies subject to the Audit Act and no authority over bodies not subject to the Act. However, the Minister for Finance can attempt to persuade the minister for a Federal organisation not bound by the Audit Act to ensure that an audit report is acted upon by that organisation.

13.33 The Department of Finance analyses responses sent every three months by ministers to the Minister for Finance. These responses are from organisations bound by the Audit Act and those not so covered. Supply Divisions within the Department of Finance responsible for advising their Minister on each portfolio's annual estimates assess whether the response from each minister

is appropriate. Each minister's response on every audit recommendation is classified as:

action completed: all criticisms raised in relation to a matter were addressed and the appropriate action taken;

action progressing satisfactorily; and

action not progressing satisfactorily.

13.34 The Department of Finance then assesses whether it should pursue recommendations where action was not progressing satisfactorily. A progress report is prepared for the Minister for Finance every six months. The report contains details on all matters identified by the Department as progressing unsatisfactorily and assessed as being significant enough to bring to the Minister for Finance's attention. The latter may then write to the relevant minister detailing appropriate action for the agency within his or her portfolio to take.

13.35 Other data provided by the Department of Finance revealed the following patterns:

Auditor-General's reports from March 1986 to March 1988 listed 495 unsatisfactory audit findings;

317 of these were classified as being resolved;

progress was satisfactory on 171 findings;

progress was unsatisfactory on 7 findings.

13.36 In other words, according to the DOF, auditees responded positively by implementing or giving sound reasons why they should not take action on 488 or 98.6 per cent of the 495 unsatisfactory audit findings. The Committee felt ambivalent about these statistics. On the one hand the data suggested high auditee responsiveness and even compliance with audit advice. However, the data may also have pointed to premature classification of auditees' responses as having resolved outstanding matters or as progressing satisfactorily.

13.37 DOF is dependent on government agencies providing accurate information on their response to audit reports. As the Secretary of the Department of Finance said⁶:

Most of them probably are telling the truth.

6. Joint Parliamentary Committee of Public Accounts, Minutes of Evidence, Reform of the Australian Audit Office, 10 October 1988, p. 1351.

13.38 DOF does not have the resources to determine whether these agencies are always truthful.

Efficiency Audit Reports

13.39 The follow-up procedure on efficiency audits is the same as for other kinds of audits. However, there are differences in procedures for recording ministers' responses to efficiency audit reports. Notably, each Supply Division keeps its own records on auditee progress in consideration and implementation of recommendations. These data are generally not stored on computer unlike data on auditee's responses to the Auditor-General's March and September reports on regularity and project audits. This decentralisation of responsibility for judgement on the necessity for follow-up is warranted given the Supply Divisions' critical role in recommending each portfolio's forward estimates.

13.40 On occasion, Supply Divisions in the Department of Finance have underestimated the importance of efficiency audit findings and overestimated auditees' responses. An example was the Department of Veterans' Affairs response to efficiency audits of Repatriation General Hospitals. Documentation made available to the Committee by the Department of Finance suggested that although the latter was concerned about the Department of Veterans' Affairs responses to the efficiency audit findings, the Department of Finance did not apply significant pressure to the Department to rectify major inadequacies in the management of Repatriation General Hospitals. Public Accounts Committee interest in the issue led to a Parliamentary report which strongly criticised the Department of Veterans' Affairs slowness to respond to serious criticisms⁷.

13.41 The Department of Finance appeared to examine quarterly responses from the Minister for Veterans Affairs in a mechanical way with little actual analyse of those responses. What was disturbing to the Committee was:

the lack of specificity by the Department of Veterans Affairs on the issue of monitoring the extent of services provided by visiting medical specialists;

the apparent Department of Finance failure to note this inadequacy; and

7. Joint Parliamentary Committee of Public Accounts, A Better Deal For Our Veterans. The Management of Repatriation General Hospitals by the Department of Veterans Affairs, AGPS,

the inconsistency in the Department of Finance's own response since in other circumstances the Department of Finance was pressing for more attention to program monitoring.

13.42 While the Department of Finance looks at ministers' quarterly responses on behalf of their portfolios, there was no evidence of whether the Department of Finance's Supply Divisions noted patterns of non-implementation or examined whether auditees experienced recurring difficulties in their responses to audit reports. Clearly, however, the Supply Divisions are well placed to undertake such trend analysis.

13.43 Such oversight and analysis is consistent with one of the main functions of the Department which is⁸:

(to foster) the efficient and effective use of resources through assistance in overseeing human resource management, and the finances and financial practices of departments and statutory authorities.

13.44 The Committee supported the Department of Finance's plans for its Financial Management and Improvement Branch to examine ministers' quarterly returns with the purpose of determining where departments and other auditees had problems, for example, in preparation of financial statements or in the derivation of performance indicators. After such analysis, the Financial Management and Improvement Branch should be able to advise auditees on how to overcome such problems.

13.45 The Committee recommends that:

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

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

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

8. Department of Finance, Annual Report 1987-88, op. cit., p.2.

13.46 These recommendations should have a positive effect on the quality of ministers' initial responses.

The Auditor-General

13.47 Once regularity audit reports are tabled, unsatisfactory findings are followed-up in the next audit report due one year later. There are no mechanisms for automatically following-up unsatisfactory findings in performance audits of a project or efficiency audit kind, although the Auditor-General may do so.

13.48 In comparison, the Canadian Auditor-General tracks all audit reports two years after they are released to determine auditee response⁹. This is in addition to any Parliamentary follow-up. A chapter in the Canadian Auditor-General's report to Parliament is devoted to follow-up of recommendations in previous reports¹⁰.

13.49 In general in Australia, action arising from unsatisfactory findings in performance audits is seen by Audit as the responsibility of Parliamentary committees and the Department of Finance rather than as its responsibility. A further factor which weakens the Australian Audit Office's follow-up of its recommendations is that such action requires resources. The proportion of Australian Audit Office resources able to be devoted to efficiency audits has fallen in recent times, decreasing the number of efficiency audits. Absorption of resources into reviewing auditees' responses to efficiency audit reports would reduce the number of efficiency audits even further. This is highly likely given the protracted nature of auditor-auditee discussion of efficiency audits and senior staff's involvement.

13.50 The Audit Office has chosen to undertake as many efficiency audits as it can in preference to following-up existing reports. The Committee understands the reasons for the Audit Office's choice, and supports the Auditor-General's right to decide which recommendations in which reports he will pursue at a later date. There is no alternative but for the Auditor-General to exercise his judgement on follow-up priorities in view of the very limited resources available for efficiency audits. Notwithstanding, the Committee believes that the virtual abandonment of any systematic follow-up of performance, especially efficiency, audits is a premature withdrawal of Audit Office pressure on auditees to consider report recommendations. Further,

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9. Minutes of Evidence, Joint Committee of Public Accounts, Reform of the Australian Audit Office, 26 October 1988, p.1672.
 10. Report of the Auditor-General of Canada to the House of Commons, Fiscal Year Ended 31 March 1987, Minister of Supply and Services, Ottawa, 1987, Chapter 16.

since financial statement audits are followed-up automatically and performance audits are not, the entire system of performance audits is threatened with relegation to second-class status. The lack of systematic follow-up of performance audits also calls into question the Audit Office's corporate objectives which state that its goal is to improve the economy and efficiency of public administration in the Commonwealth sector. The obvious retort is that the Audit Office has given performance audit follow-up a lesser priority in preference to the commissioning of new performance audits. The Committee is not entirely satisfied with this response since it expects the Auditor-General to accept responsibility for follow-up of his own recommendations.

13.51 The Committee recommends that:

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

13.52 The dominating pattern of audits has been that statutory authorities have been subjected to financial statement audits with very few performance audits, while departments and their outliers have had performance audits without financial statement audits. This emphasis has not provided adequate audit coverage, and has made nonsense of the Audit Office's attempt to develop comprehensive audits. In future, as argued elsewhere, more efficiency audits should be undertaken of statutory authorities, and because of Government action on a long-standing Public Accounts Committee recommendation, departmental outriders will now prepare financial statements which will be audited.

13.53 Consequently, Audit must return to departments more often; similarly with statutory authorities where more efficiency audits are likely.

13.54 The Committee recommends that:

Follow-up procedures for performance audits be linked to follow-up procedures for regularity audits in the Audit Office.

13.55 This will lead to an annual review of progress in responding to performance audit findings. The Auditor-General, as highlighted earlier, should retain the right to decide which performance audit recommendations are of most importance and should be followed-up. There is no expectation that auditees should automatically act upon audit findings, but they should demonstrate, if they do not implement recommendations, that they have sound reasons for their decisions.

13.56 The Auditor-General retains the power to report to Parliament if he is not satisfied with auditees' responses to audit recommendations. This power has not always been exercised with efficiency audit recommendations. Awareness of this led the House of Representatives Standing Committee on Expenditure to recommend in 1986 that the Australia Audit Office should advise Parliament at the first available opportunity of deficiencies in the consideration and implementation of efficiency audit recommendations¹¹. The Committee supports and restates this recommendation.

13.57 The Committee recommends that:

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

13.58 There are other initiatives which the Auditor-General can take to raise the profile of auditing within government. One such initiative is personally and regularly to brief ministers and Prime Ministers on principal audit findings, including major findings from his biannual reports. (Sections 45, 63G and 63L give him that authority already). This practice was adopted in Victoria by a previous Auditor-General who briefed the State Premier on results of major audits. Briefing should occur immediately before report tabling to remove any suggestion that an Auditor-General could weaken audit findings to please Government.

13.59 The Committee recommends that:

The Auditor-General brief Ministers and the Prime Minister regularly on significant audit findings.

13.60 The Auditor-General's messages on efficiency and effectiveness are not always palatable to Executive Government. Therefore, despite the importance of many audit findings, there is an understandable reluctance of governments of all persuasions and auditees to acknowledge audit findings publicly. It is very easy in these circumstances for audit findings to be buried. The media can be a useful tool for the Auditor-General to draw attention to critical findings. The Committee noted the Canadian practise

11. A Taxing Problem, op. cit.

whereby the media are permitted access to the Auditor-General's annual audit report a few hours before it is tabled in Parliament. Access is granted in a secured environment similar to the media 'lock-up' for the Australian Budget. The Canadian media have a well-developed interest in the Auditor-General's reports, and media reports maintain pressure on the Canadian Government to consider audit findings. Development of a similar relationship between the Auditor-General and the media in Australia is warranted. In turn, this would maintain public pressure on government and Parliament to increase action on public sector probity and efficiency.

13.61 There is much more that the Audit Office could do to inform and educate Parliamentarians about audit: for example, the Audit Office could brief Members and Senators on critical findings in notable reports. Also, the Audit Office could experiment with communication about its work, for instance, through preparing brief video reports on some audits. The Canadian Auditor-General has found that brief video reports can assist busy Parliamentarians who may not have time to read an entire report.

13.62 Through giving more attention to relations with the media, the public and parliamentarians, the level and amount of debate on audit findings will increase.

Summary

13.63 The main features of the current approach to consideration of audit findings are:

there is no single approach to consideration and implementation of audit findings. Rather there is a loosely connected set of approaches which have developed over a very long period;

many players are involved, - the Auditor-General, auditees, auditees' ministers, Parliamentary committees, the Department of Finance;

each major participant or group of participants can have different estimates of the importance of audit findings. Therefore, some conflict is inevitable in discussion of these;

findings of regularity audits are followed-up systematically by the Auditor-General;

there is almost no attention given by the Auditor-General to follow-up of efficiency audits;

more could be done by the Auditor-General to raise the profile of significant audit findings; and

there is a necessary duplication and overlap of responsibilities. Equally, there are some responsibilities identified here which should be pursued more vigorously.

Chapter 14

INTERNAL AUDIT

14.1 The discussion in earlier Chapters highlighted the slow real growth in funds for the AAO, and how the increase had not matched growth in the size and complexity of AAO responsibilities. A 'softening' thought on this imbalance was that improvements in the internal audit of Commonwealth organisations may have reduced the need for the same extent of external audit coverage.

14.2 The Institute of Internal Auditors has defined internal auditing as an independent appraisal activity for the review of accounting, financial and other operations as a basis for service to management. It is a managerial control which functions by measuring and evaluating the effectiveness of controls¹. If effective internal controls, such as internal audit, are in place, then public service managers, ministers and Parliamentarians can have more faith in the accuracy of Budget - dependent agencies' financial statements and forward estimates. A major distinction between internal and external audit is that the former is an arm of management while external audit is accountable to its client, which in the case of the Commonwealth sector is the Commonwealth Parliament.

14.3 If reliance cannot be placed on the work of internal audit units, the work of the AAO has to be expanded to ensure that financial systems are in place and capable of providing accurate information.

14.4 Many factors affecting the Audit Office and described earlier also affected internal audit. Thus, internal audit has become involved in efficiency audits². This was an example of how the roles of internal and external auditors overlapped or were complementary. Consequently, this Committee believed there was considerable value in the Commonwealth giving more attention to how the standard of internal audit could be maintained.

14.5 The AAO's usage of internal audit was criticised during the course of the inquiry. The main criticism was of how the AAO

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1. Joint Parliamentary Committee of Public Accounts, Internal Audit in the Australian Public Service, - A Discussion Paper, 184th Report, AGPS, Canberra, 1981, p.11.
 2. Coopers and Lybrand Submission, 27 August 1988.

duplicated the work of internal audit by examining areas which internal audit had reviewed recently or was in the process of reviewing³. A second criticism was that the Audit Office interpreted co-operation with internal audit as a one-way street. It was alleged that departments must supply copies of audit manuals and annual plans to the Audit Office, but received little, if anything, in return⁴.

14.6 In reply to these criticisms, the AAO advised that it undertook extensive discussions with internal audit so that their plans could be taken into account in planning the AAO's work. If internal audit had undertaken a recent audit, then the AAO would defer its own examination and rely on the work of the internal audit. The AAO also reviewed internal audit to assess the quality of its work⁵.

14.7 Evidence presented to the Committee did not indicate that there was a high degree of duplication of internal audit work by the AAO. In any case, some duplication of effort was warranted in order for the Audit Office to be able to provide assurances of the quality of internal audit. Notwithstanding, the Audit Office should continue to monitor any overlap with internal audit to ensure that where duplication of effort occurred it occurred for good purpose.

14.8 Speculation is necessary on how government organisations have responded to the reduction in resources for external audit relative to the size of the audit task. This trend was chartered in Chapter 3. Undoubtedly, some organisations would have responded by raising the prominence of internal audit and strengthening internal controls. Other organisations would have given less attention to internal audit. No longitudinal data were available to indicate which was the major trend. However, some 1988 data were available.

14.9 In July and August 1988, the Audit Office conducted a limited sample survey of internal audit in 18 departments and outliers and 41 statutory authorities and government companies. The survey was undertaken to provide more information on issues raised in the inquiry. The findings of the sample survey were as follows⁶:

14.10 From July 1987 to July 1988:-

the internal audit establishment fell from 776 to 713, or by 9.2 per cent;

3. DEET Submission, op. cit., para. 42.

4. Institute of Internal Auditors, Australia, Canberra Chapter, Submission, 2 August 1988, para. 7.

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

6. D Hill to Secretary, JPCPA, 2 September 1988.

actual internal audit staff numbers fell from 747 to 674 or by 10 per cent. This reduction in resources for internal audit may have been an example of risk management;

most departments and outriders devoted less than 50 per cent of their audit resources to compliance and regularity auditing;

the majority of statutory authorities and companies devoted most internal audit resources to compliance and regularity auditing;

almost 25 per cent of all departments and outsiders had combined their internal audit resources with other areas, such a management improvement, evaluation and review and performance monitoring; and

29 per cent of organisations surveyed, including 41 percent of statutory authorities and Government companies, had contracted all or part of the internal audit function to the private sector.

14.11 Three models of internal audit were evident in the Commonwealth sector, with a focus on:

performance auditing and monitoring;

performance and regularity auditing; and

regularity, including compliance and financial, auditing.

14.12 Machinery of government changes, including formation of large departments, occurred in the period covered by the survey. Reductions in staff numbers shown above, therefore, partly reflected economies required by the merging of administrative functions. In 1987-88 in agencies subject to staff budget control, average staffing levels fell by between 5.5 and 0.7 per cent (depending on which definitions were used)⁷. Management service areas were subject to greater cut-backs in staff than many other areas after the July 1987 administrative rearrangements. Even so, it appeared that internal audit had been particularly hard hit at a time when it was facing new demands. These new demands arose from the requirement that departments and other authorities should prepare financial statements for the first time and commencing with the 1988-89 financial year. It is expected that management of Commonwealth sector organisations will rely even more than previously on internal audit as a result of this innovation.

7. Portfolio Program Estimates 1988-89, Budget Paper No. 3, AGPS, Canberra, 1988, p.9.

14.13 What was unclear was whether the reduction in resources for internal audit suggested by the Auditor Office's limited 1988 survey was offset by improved efficiencies in the internal audit function. No evidence was presented to the Committee to suggest that this was the case. A caveat, though, is that the Audit Office survey presented suggestive rather than definitive evidence on the state and role of internal audit.

14.14 If the Commonwealth sector as a whole was devoting fewer resources to internal audit, the the reduction in attention to this vital internal control will require greater attentiveness and more work by the Audit Office, and more resources.

14.15 It is possible that more staff will be allocated to internal audit during 1988-89 to assist in preparation of departmental financial statements. If so, then mid - 1988 will be seen as internal audit's nadir. It is too early for any patterns to be clear at this stage.

14.16 The Committee recommends that:

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

14.17 The former Public Service Board had a role in improving financial management including internal audit. Since the Public Service Board's disbandment, the DOF has further developed its role in financial management improvement in Budget-dependent agencies. However, the DOF does not appear to have a clear role or, indeed, any charter at all to ensure that internal audit in Budget-dependent agencies is adequate. The latter is now almost exclusively seen as a responsibility of departmental secretaries and chief executive officers.

14.18 In the Committee's opinion, these officials undoubtedly have the primary responsibility for maintaining satisfactory internal financial controls of which internal audit is a part. But there remains the important task of monitoring the quality and adequacy of internal controls across the Budget sector, and of taking initiatives to address common problems. The Department of Finance is the logical executive government agency to have this responsibility since the latter would be an addition to its existing responsibility to promote the quality of financial management. Yet the DOF has no formal charter to take steps to improve internal audit.

14.19 An example from the State sector is pertinent. The Victorian Department of Management and Budget has a similar role

in State Government as the DOF has in Federal Government. Recently, the Department of Management and Budget has taken steps to improve the quality of internal control across the Victorian State Government sector⁸.

14.20 The Committee recommends that:

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

8. Victorian Department of Management and Budget, Internal Audit in the Victorian Public Sector: An Introduction to the Function for Management and Staff, Department of Management and Budget, Melbourne, 1987.

Chapter 15

PROFESSIONAL ASSOCIATIONS AND AUDIT STANDARDS

15.1 Major links between the Australian Audit Office, the auditing profession and private sector audit practice were as follows:

55 per cent of AAO staff were members of the Australian Society of Accountants, ASA;

5 per cent of AAO staff were members of the Institute of Chartered Accountants, ICA;

successive Auditors-General have been members of the Australian Society of Accountants Auditing Standards Board;

the AAO issued auditing standards, which itself and other auditors of Federal Government organisations must follow; and

for the future, the Committee has recommended that the Auditor-General employ private sector auditors on contract in certain situations.

15.2 A decision is necessary on whether the range of formal contacts between the AAO, the audit profession and private sector practice should be augmented. An argument in favour of increased linkages was that these may break down one image of the Audit Office as being an insular or inward looking organisation.

15.3 Major difficulties in the AAO attracting and retaining quality staff were because of:

income differences between private and public sector auditors (these are discussed elsewhere in this report); and

the Audit Office's image.

15.4 Images of the Audit Office within the profession were confused and sometimes contradictory. Often they were based on outdated information. Notwithstanding, they were factors which could not be ignored. Essentially, within the audit profession, the Audit Office was seen as having valuable clients but not being at the 'cutting edge' of the profession. One exception was in the conduct of efficiency audits of Government agencies where the Audit Office was considered to have more experience. Another exception was that the Audit Office was seen to be more knowledgeable about government rules, regulations and procedures than private sector auditors. It was not surprising to discover that the Audit Office was believed to have advantages in these two areas. Nevertheless, the largest accounting firms believed that they were 'in front' of the Audit Office in the audits of financial statements and accounts and records of commercially oriented organisations. It was unclear to what extent this had developed because of legislative constraints on the AAO.

15.5 The Committee did not seek to prove or disprove these claims. However, that they were widely held was incontestable. This image problem creates difficulties for the Audit Office in attracting and maintaining staff. To some extent, recruitment of graduates and of persons beginning in the profession was made easier by starting salaries comparable or a little better than in the private sector. However, Audit Office salaries lagged far behind those in the private sector from the level of audit manager upwards. It will be recalled that only 3 of the 85 staff recruited to the AAO in 1987-88 came from the private sector¹.

15.6 Setting aside the salaries issue, what can be done to improve the image of the Audit Office within the accounting profession? There could be much more interaction with the private sector on strategic and technical issues, greater recruitment of senior staff from the private sector, and regular interchanges with audit firms. This latter has some risks because of possible 'poaching' or the attraction of higher salary.

15.7 The Committee recommends that:

The Auditor-General appoint a consultative or advisory committee with representatives from the private sector, universities and auditees. The committee would advise him on developments in private sector audit. It would assist in identifying emerging problems or issues, and would be a source of strategic advice including contracting of audits (section 11 of the Audit Act 1901). Further, the committee's

1. C. Monaghan to Secretary, JCPA, 11 August 1988.

terms of reference be drafted to avoid any impression that it would reduce the Auditor-General's independence and status.

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

An interchange scheme be initiated wherein Australian Audit Office staff would work in private sector audit firms.

There be major recruitment of senior staff from either within or outside the public sector.

15.8 The Committee believes it is essential that such a recruitment program succeed. This recommendation is made fully realising that large increases in salaries will be necessary for some key officers.

15.9 The AAO has given great attention to the development of international co-operation in public sector audit through membership of the International Organisation of Supreme Audit Institutions, INTOSAI. Currently, the Australian Auditor-General is INTOSAI chairperson, which indicates the high regard in which the AAO is held internationally.

15.10 Within Australia, the AAO participated in regular meetings of Auditors-General from the States and the Northern Territory. The New Zealand Auditor-General frequently participated in these meetings.

15.11 These national and international meetings, which pointed to the sharing of ideas and approaches in public sector audit, were essential for maintenance of the quality and integrity of public sector audit in Australia.

15.12 The irony was that the AAO did not appear to have given the same attention to development of its relationship with private sector auditors in Australia. The above recommendations seek to redress this imbalance.

15.13 As quoted earlier, 55 per cent of AAO staff were ASA members while 5 per cent were ICA members. Considering the largest accounting firms with which the AAO compared itself, the AAO had an under-representation of ICA members. This may or may not have changed the Office's effectiveness. Young auditors who wish to become Institute members do so by having a year of professional training with an Institute member, preferably a partner in an audit or accounting firm. No member of the 24 person AAO Senior Executive Service, SES, which was the Office's leadership and management, was an Institute member. Therefore, there was no one within the Audit Office with the background necessary to train a young auditor for Institute membership.

15.14 The AAO had many highly skilled, first class auditors who were not Institute members. However, in order to attract greater numbers of quality young auditors, the AAO must be able to offer to them the further education and training to which many aspired. It must be stressed that the AAO is competing for staff when there is a severe shortage of qualified accountants.

15.15 Turnover amongst audit staff within the private and public sector has increased in recent years. There is no sign of a decrease in the rate of staff mobility, even amongst the most prestigious private firms. Therefore, the general pattern of recruitment of young graduates or graduates with a few years experience, followed by on-the-job experience and training for a number of years, and then movement to other auditing or accounting employment (or to employment elsewhere in the financial sector) will remain. This will continue to be accompanied by movement of staff between the private and public sectors.

15.16 In the long term, the AAO's image will be improved if, first, it acknowledges more openly that this pattern of staff mobility is likely to remain for the foreseeable future, and, second, if it designs staff recruitment and training policies with this pattern of staff mobility in mind.

15.17 Many young graduates do not seek AAO employment because the AAO cannot offer the training and experience necessary for them to become members of the Institute. Current recruitment policies were appropriate for those young auditors and accountants who wished to become ASA members, but they were unsatisfactory for those who wished to become ICA members. In the Committee's view, ASA and ICA membership was of equal utility to the AAO. However, the Committee's views were less important than the opinions of the auditors whom the AAO needs to recruit. The reality is that, since many of these want to become ASA members and many wish to become ICA members, AAO recruitment policy should be responsive to both sets of aspirations.

15.18 Presently, the AAO is almost powerless to change its recruitment policies because:

any senior AAO staff with ICA membership were likely to be attracted to the private sector in search of higher incomes, while experienced private sector auditors with ICA membership were unwilling to apply for AAO jobs because of the likely severe fall in income; and,

even if senior staff had ICA membership, the AAO could not unilaterally declare that it was training auditors for the Institute. Beforehand, the Institute's approval must be gained.

15.19 ICA membership involves training in other fields such as taxation, business evaluations and insolvencies, and cost accounting. The AAO cannot offer training in all fields. Notwithstanding, there is still much training which the AAO could offer, perhaps in co-operation with other parts of the Commonwealth sector such as the Australian Taxation Office and commercially oriented government organisations. Of note is that the Canadian Institute of Chartered Accountants classifies the Canadian Auditor-General's Office as being equivalent to a firm of chartered accountants for training purposes.

15.20 The Committee recommends that:

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

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

15.21 The objectives of these recommendations are to raise the profile of the AAO in the auditing profession. In some ways, this will mean that the AAO will move closer to the model of the largest accounting firms which have many more chartered accountants than the AAO. If the recommendations are accepted, then, within five years, the proportion of AAO who are Institute members will be significantly greater than the current level of 5 per cent, and a significant proportion of SES staff will be Institute members, or even of both bodies.

Chapter 16

INDEPENDENT AUDITOR OF THE AUSTRALIAN AUDIT OFFICE

16.1 An innovation with the 1979 amendments was the introduction of the position of Independent Auditor of the Australian Audit Office. The functions of the Independent Auditor are to¹:

carry out audits of the Australian Audit Office's accounts, records, and financial statements; and

execute efficiency audits of the Australian Audit's Office operations.

16.2 The first Independent Auditor was appointed in May 1979 for a three year term. He was re-appointed in May 1982 and May 1985 for further three year terms. In June 1988, the Minister for Finance announced the appointment of a new Independent Auditor for three financial years commencing with the 1987-88 financial year.

16.3 Each year the Independent Auditor's opinion on the Australian Audit Office's financial statements has been published as an Appendix to the Auditor-General's report on the Financial

1. Section 48K of the Audit Act 1901 states:

- (1) The Minister may, on behalf of the Commonwealth, make arrangement for time to time, with a suitable person to exercise the powers and perform the functions of the independent auditor under this Division.
- (2) For the purposes of this Division, the functions of the independent auditor are:
 - (a) to carry out audits of the accounts and records kept, in accordance with section 40, in relation to the Australian Audit Office;
 - (b) to examine such parts of the statements transmitted to the Auditor-General under section 50 as relate to the Australian Audit Office;
 - (c) to examine the accounts of the stores of the Australian Audit Office;
 - (d) to carry out efficiency audits of the operations of the Australian Audit Office;
 - (e) to furnish, in accordance with this Division, reports of the results of audits and examinations so carried out by him.'

Statements prepared by the Minister for Finance for the previous financial year, (Appendix 12). The Independent Auditor also undertook audits of the Australian Audit Office's accounts and records, the results of which were reported in the Auditor-General's annual reports². Two efficiency audit reports on the Australian Audit Office were released in March 1982 and December 1987³.

Appointment

16.4 The two Independent Auditors were appointed from the private sector. The firms to which they belonged did not have audit business with the Federal Government at the time of appointment. Contracts for the position of Independent Auditor were signed with the individuals as required by the Audit Act (section 48K), not with the audit firms.

16.5 An existing criterion for appointment, which is an expectation that the firm of the individual appointed to the position of Independent Auditor must not have an audit contract with the Government, should be relaxed. However, the individuals's firm should not have contracts with the Audit Office for audits or other activities.

16.6 The Committee recommends that:

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

16.7 The Independent Auditor is appointed by the Governor-General on the advice of the Minister for Finance. This arrangement was instituted because the Minister for Finance has been responsible for administering both the financial management and audit provisions of the Audit Act. The next Chapter recommends repeal of the Audit Act and its replacement by two separate acts, a financial management act and an audit act. Chapter 5 recommended establishment of an Audit Committee of Parliament, which would have responsibility for recommending the Audit Office's annual appropriation.

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2. Annual Report of the Australian Audit Office, op. cit., 1984-85, p.96; 1985-86, p.105; 1986-87, p.83.
 3. E. Cameron, Report of the Independent Auditor on an Efficiency Audit of the Auditor-General's Office under the Audit Act 1901, AGPS, Canberra, 1982. E. Cameron, op. cit., 1987.

16.8 The Committee recommends that:

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

16.9 Appointment should be for a limited period. Tenure should be sufficient for the Independent Auditor to be able to acquire the knowledge of the Australian Audit Office necessary to conduct efficiency audits.

16.10 The Committee recommends that:

- . Appointment of Independent Auditor of the Australian Audit Office be for a minimum term of three years and a maximum term of five years.

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

Role

16.11 The Independent Auditor can be a source of independent criticism and advice for the Audit Office. To perform this role satisfactorily, more performance audits will be necessary in addition to financial and regularly audits. Between 1979 and 1987, two performance audits of the Australian Audit Office were undertaken. The first efficiency audit was undertaken when efficiency audit methodology was new, and the second was attempted when the methodology was better developed. These efficiency audits did not lead to any serious re-thinking within the Australian Audit Office of its approaches. Nor did these efficiency audits alert Parliament to any fundamental problems in the Australian Audit Office, which have included very high staff turnover and acute resource shortages for all kinds of audits.

16.12 Therefore, in practice, the Independent Auditor's major contribution over nearly a decade was to affirm the accuracy of the Australian Audit Office's financial statements. This remains a very important function. However, this contribution was insufficient to reassure Parliament that the Audit Office's work

was in accord with the best professional practice, and that the Australian Audit Office was well managed.

16.13 One reason for this inadequacy was that the PAC was remiss in never meeting with the first Independent Auditor during his appointment from 1979 to 1987. Therefore, the first Independent Auditor never received any Parliamentary advice on his responsibility. That advice always came from executive government through the Department of Finance. The PAC has sought to develop its relationship with the Independent Auditor by meeting with the second incumbent in 1988 nine years after the position was established by legislation. Regular meetings are planned in future.

16.14 Clearly it is the Auditor-General's responsibility to alert Parliament to major problems in administration of his or her legislated functions. Auditors-General have largely accepted this responsibility, although since the first separate annual report by an Auditor-General was prepared only as recently as 1985, there has been a distinct lack of one notable avenue by which an Auditor-General's concerns could be communicated to Parliament.

16.15 An Independent Auditor's examination and statements on similar matters provide Parliament with another benchmark. This notion of establishing a benchmark or reference point for looking at the Australian Audit Office has been of high importance since the position of Independent Auditor was created. Notwithstanding, the Independent Auditor was under-utilised by both the executive and legislative arms of government from 1979 when the first Independent Auditor was appointed until 1988 when his successor was installed. Under-utilisation resulted in less pressure on the Audit Office to keep up to date than was warranted.

16.16 This situation will not be acceptable in future. The Audit Committee of Parliament must have a clear brief which includes responsibility for advising the Independent Auditor on his or her role. This advisory role would include provision of advice or guidance on the number of performance audits to be undertaken and the subject matter of those audits. A situation where there were more performance audits, for example, of audit methodology or of resource deployment, would provide Parliament with better assurances than it has currently of the suitability of the Audit Office's techniques and the efficiency of its resource usage. Notwithstanding, under the proposed arrangements, the Independent Auditor would remain free to choose the numbers and kinds of performance audits necessary, in addition to audits of financial statements and accounts and records.

16.17 This stronger, better defined role for the Independent Auditor would strengthen the Auditor-General's accountability to Parliament.

PART E
THE FUTURE

Chapter 17

FUTURE FUNDING

17.1 The question of the future level of funding of the AAO is addressed separately for regularity and performance audits. An overall comment is that total funding for the AAO is inadequate since resources must be directed from performance audits in order to maintain regularity audits.

Regularity Audits

17.2 There was no evidence presented to the Committee to indicate that resources for financial audits were inadequate. In other words, formulas used to set resource levels for financial audits appeared to be satisfactory. Notwithstanding, the analysis in Chapter 3 of AAO resources and responsibilities over a ten year period raised doubts about current approaches to determining the adequacy of resources for regularity audits.

17.3 Economies are possible in financial audits. Audits of financial statements prepared by the Minister for Finance, for example, consume approximately 10 per cent of the AAO's resources and is the AAO's largest single audit. Introduction of financial statements by departments and other Budget - dependent agencies provides the Audit Office with an opportunity to reconsider its approach to audit of the financial statements prepared by the Minister for Finance, and second, whether economies can be made in the audit. Such reconsideration may liberate resources for additional financial statement audits although it would have no effect on total resources for financial audits.

Performance Audits

17.4 The present situation wherein resources are diverted from efficiency audits to fund financial or regularity audits is unjustifiable. It is a direct result of how efficiency audits are discretionary while financial or regularity audits are mandatory. When the efficiency audit legislation was enacted most discussion was of the need to legitimise efficiency audits as a valid activity for the Audit Office. Far less, if any, attention was given to the question of how many efficiency audits were

desirable and necessary. Prior to the 1979 amendments, Parliamentary debate and analysis within administrative circles emphasised the need for the Audit Office to build up its resources slowly for the new activity. This was done. After ten years experience, the Audit Office still devotes only a relatively small amount of resources for efficiency audits. This situation was not expected when the 1979 amendments were passed. Meanwhile, resources for performance audits as a whole, including both efficiency and project audits, are approximately half of what they were at the introduction of efficiency audits.

17.5 The inconsistency in the legislation is that although efficiency audits are discretionary, they are also highly useful tools to maintain the efficiency of public sector organisations and programs. Notwithstanding, there are other ways of improving public sector efficiency.

17.6 The DOF's emphasis on program budgeting and greater devolution of responsibility to managers are major innovations to improve public sector efficiency and effectiveness. In fact, the purported additional discretionary authority and responsibility of program managers does not diminish and may increase the need for accountability mechanisms. Program budgeting is not developed sufficiently to permit heavy reliance on it to ensure that Parliament is kept informed of changes in efficiency. Consequently, and as argued earlier, these innovations do not reduce the need for efficiency audits.

17.7 The Audit Act does not specify how many efficiency audits should be done. It does not even require the Auditor-General to conduct efficiency audits since these are at his discretion. On the other hand, the Auditor-General is expected to undertake financial and regularity audits.

17.8 Parliament has never indicated to the Auditor-General how many efficiency audits he should do, nor how many resources should be allocated to this kind of audit.

17.9 Executive government, as far as can be determined, has never officially informed the Auditor-General of its opinion of how many resources he should allocate to efficiency audits nor how many of these he should aim to complete. The Department of Finance, nevertheless, on behalf of executive government has determined the Audit Office's resources.

17.10 The Auditor-General is free to determine how many resources he sets aside for efficiency audits, but this freedom is circumscribed by the mandated requirement to undertake financial and regularity work. With a given amount of resources it is true to say that he has the discretion to commence as many efficiency audits as he wants. However, resource requirements of the methodologies necessary to address particular problems are

limits on his choice. This last kind of limit applies to any level of resources the Auditor-General might have.

Effects of Current Resources

17.11 The audit cycle is defined as the number of years it takes to subject all programs with certain characteristics to an audit. In the case of audits of financial statements of statutory authorities, the audit cycle is one year since financial statements are audited annually. The audit cycle for efficiency audits of programs is far longer. In 1987-88, the Commonwealth government funded 826 programs. 350 of these programs had income or expenditure of at least \$10m and 476 had less than \$10m in income or outlays.

17.12 Table 17.1 shows that if 1987-88 trends continued, it would take approximately 40 years with current resources before every program with income or expenditure greater than \$10m was subjected to an efficiency audit.

17.13 Table 17.2 provides more information, indicating that if 1987-88 trends continued, it would take the following number of years to complete efficiency audits of all programs with income or expenditure of \$10m or more in the following kinds of government organisations:

54 years in statutory authorities;
48 years in departments; and
20 years in departmental outriders.

17.14 In that year, no efficiency audits were conducted in government companies or in departmental commercial undertakings.

17.15 In 1987-88 the AAO:

completed 8 efficiency audits;
allocated \$1m for staff costs for these; and
set aside 6 per cent of total AAO resources for efficiency audits.

17.16 The 350 programs with individual allocations of at least \$10m had a combined value of approximately \$84b. In other words, \$1m was available for the efficiency audits of programs with a value of \$84b.

TABLE 17.1

Summary of Costs of Various Cycles of Efficiency Audits

Length of Efficiency Audit Cycle (in years)	Resources (\$m)
1987-88 40 year average	1.0
10 years	8.2
5 years	15.5
3 years	20.9
AAO Preferred	16.7

17.17 These statistics indicated that efficiency audits were an activity of marginal importance to improving the efficiency and effectiveness of public administration in Australia.

Overseas Comparisons

17.18 In other countries, efficiency audits are often called value for money audits. In 1988-89, 10 per cent of the New Zealand Audit Office's resources were allocated to value for money studies and other special investigations. The target is to apply 25 per cent of total resources to value for money and related reporting activities.

17.19 42.8 per cent of resources of the Canadian Audit Office were set aside for value for money audits in 1988-89¹. 45 per cent of staff resources of the National Audit Office in the UK were for value for money audits in 1988-89. The objective is to increase this to 54 per cent within 5 years by 1993-94. This will involve an increase in the number of reports from 39 to 53².

17.20 The AAO devotes substantially fewer resources to efficiency or value for money audits than national audit offices in any of these countries. No good reason was given during the inquiry for continuation of this situation.

Principles

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

A legislative requirement for efficiency audits;

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

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

Funding should be based on the AAO's performance in regard to efficiency audits.

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1. Office of the Auditor-General of Canada, 1988-89 Estimates, Part III, Expenditure Plan, Minister of Supply and Services, Ottawa, 1988, p.27.
 2. The National Audit Office Corporate Plan for 1989-90 to 1993-94, NAO, London, 1988.

A legislative requirement for efficiency audits

17.22 This requirement would have two components:

inclusion in audit legislation of the need for the Auditor-General to plan and execute a cycle of efficiency audits; and

special examinations on a regular basis, within every portfolio. These activities which would be selected by the Auditor-General, may include a program or programs, or they may involve a special examination of an entire organisation. Such a distribution of effort across portfolios would ensure a coverage of all government activities.

17.23 Design of a cycle of efficiency audits must consider the duration of programs since there are probably more short-term programs, for example, of three years duration than there were a decade ago. The approach to and need for efficiency audits of short-term and long-term programs may be different.

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

17.24 Insulation of the funding basis for efficiency audits from the funding of financial audits was essential to counter the current arrangement wherein increases in the number of financial statement audits automatically diminished the number of efficiency audits. However, the Auditor-General must be given the discretion to reallocate a proportion of funds from one kind of audit to another depending on the need for and costs of various audits.

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

17.25 The purpose of this linkage would be to ensure, for example, that as government income and expenditure increased, more resources were made available for efficiency audits. No linear relationship is required between funds for audits and increases in government income and expenditure. The level of funds for efficiency audits must also be linked to the structure of government programs or service delivery since that structure is a major determinant of audit workload. For instance, \$1b could fund one or ten programs, possibly justifying a minimum of one or a maximum of ten efficiency audits.

Funding should be based on the AAO's performance in regard to efficiency audits.

17.26 This performance factor would provide an incentive for the AAO to maintain and develop its contribution to improving the efficiency and effectiveness of public administration. The AAO would be required to demonstrate its contribution annually. The requirement will compel the Audit Office to collect data on the effects of its findings and recommendations.

17.27 These principles must be combined into a funding formula which would be used by the Audit Committee of Parliament. Utilisation of this funding formula would mean adoption of a zero-based approach to the financing of efficiency audits.

17.28 The Committee recommends that:

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

- . a legislative requirement for efficiency audits;

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

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

the Australian Audit Office's performance in regard to efficiency audits.

Financial Options

17.29 Remembering that it would take approximately 40 years to conduct efficiency audits of all large income and expenditure programs if 1987-88 expenditure trends continued, and ignoring the cost of conducting efficiency audits of small programs, Table 17.1 provides estimates of the costs of efficiency audit cycles of briefer duration. Further data are in Table 17.2. These costs are as follows:

- . a 40 year audit cycle costs \$1m;
- a 10 year audit cycle would cost \$7.2m;
- a 5 year audit cycle would cost \$14.5m; and

Table 17.2

Costs of Various Cycles of Efficiency Audits, by Type of Government Organisation¹

Length of Efficiency Audit Cycle (in years)	Organisation Type	No. of Programs	No. of Efficiency Audits ²	Total Additional Cost (\$m) ³
1987-88⁴				
0	Govt Companies	21	0	n.a.
54	Statutory Authorities	108	2	n.a.
0	Departmental Commercial Undertakings	18	0	n.a.
48	Govt Departments	144	3	n.a.
20	Outriders	59	3	n.a.
Subtotal ⁶			8	1.0 ⁵
10	Govt Companies	21	2	0.4
	Statutory Authorities	108	11	2.4
	Departmental Commercial Undertakings	18	2	0.4
	Govt Departments	144	14	2.8
	Outriders	59	6	1.2
Subtotal			35	7.2
5	Govt Companies	21	4	0.8
	Statutory Authorities	108	22	4.5
	Departmental Commercial Undertakings	18	4	0.8
	Govt Departments	144	29	6.0
	Outriders	59	12	2.4
Subtotal			71	14.5

3	Govt Companies	21	6	1.2
	Statutory Authorities	108	36	7.3
	Departmental Commercial Undertakings	18	6	1.2
	Govt Departments	144	48	9.7
	Outriders	59	20	0.4
Subtotal			116	19.9
AAO Preferred				
20	Govt Companies	21	1	0.3
10	Statutory Authorities	108	11	2.4
5	Departmental Commercial Undertakings	18	4	0.8
3	Govt Departments	144	48	9.8
5	Outriders	59	12	2.4
Subtotal			76	15.7

1. The efficiency audit cycle refers to the number of years to complete an efficiency audit of all programs with an expenditure greater than \$10m.
2. Approximately 50 per cent of efficiency audits do not proceed beyond the diagnostic studies. These estimates are based on that expectation.
3. A labour on-costs and indirect costs overhead factor of 1.62 was obtained from the Department of Finance's discussion paper: DOF, Guidelines for Costing of Government Activities, AGPS, Canberra, May 1988.
4. The current average efficiency audit cycle for all programs with expenditure greater than \$10m is approximately 40 years.
5. This was actual 1987-88 expenditure on efficiency audits: n.a. is not applicable.
6. Estimates in the final column may not total due to rounding.

a 3 year audit cycle, which is the maximum life of a Parliament and a Government, would cost \$19.9m.

17.30 The need to re-appraise funding for project audits is ignored in these estimates.

17.31 The Committee requested advice from the Audit Office on how often it believed programs should be subjected to efficiency audits. The Audit Office replied that programs in different kinds of organisations should have different audit cycles, as follows (Table 17.2):

20 years in government companies;
10 years in statutory authorities;
5 years in departmental commercial undertakings;
3 years in departments; and
5 years in departmental outriders.

17.32 The Committee suspects that although no government company has ever had an efficiency audit, these will occur in future but only very occasionally. Notwithstanding, the expectation of one efficiency audit of a government company every 20 years is probably an underestimate.

17.33 Audit estimated that based on these efficiency audit cycles, an additional \$15.7m was necessary. This is also shown in summary form in Table 17.1 and in more detail in Table 17.2. A funding increase of that order of magnitude would mean that 50 per cent of the Audit Office's resources would be for efficiency audits and 50 per cent for project and regularity audits. This is approximately the same distribution as in national audit offices in the United Kingdom and Canada. A substantial funding increase would permit efficiency audits to make the contribution towards increased public sector productivity envisaged by the Royal Commission on Australian Government Administration in 1976.

17.34 The Committee is inclined to recommend an increase in funds for efficiency audits in a major effort to improve public sector efficiency. Consequently, substantial savings in government expenditure and improved program effectiveness is expected from greater outlays on efficiency audits. In the long run, net savings to the public purse should be greater than gross outlays on this kind of audit.

17.35 The AAO's 1988-89 budget is \$26.9m. A \$15.7m increase would be almost a 60 per cent increase in resources. The AAO could not be expected to manage such a large increase in a short period without considerable stress. Further, the Federal Government has placed strict limits on growth in public outlays.

17.36 The Committee recommends that:

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

- . a 20 year cycle for government companies;
- . a 10 year cycle for statutory authorities;
- . a 5 year cycle for departmental commercial undertakings;
- . a 5 year cycle for departmental outriders;
and
- . a 3 year cycle for departments.

17.37 This will require an additional \$15.7m. These audit cycles should be developed over a five year period from 1989-90, and be operational by 1994-95. An initial grant of \$3.1m in addition to current funding should be made in 1989-90 with the additional expenditure being phased in over five years.

Chapter 18

NEW LEGISLATION

18.1 New audit legislation is necessary:

- to establish the Audit Committee of Parliament;
- to identify the Auditor-General more clearly as an officer of the Parliament;
- to establish the procedures for appointing future Auditors-General, and to change procedures for their removal;
- to change the term of appointment of future Auditors-General;
- to define the Auditor-General's authority to settle the terms and conditions of employment of Australian Audit Office staff;
- to extend the Auditor-General's power to delegate his authority;
- to affirm that the Auditor-General is the external auditor of all Commonwealth Government bodies and organisations in which the Commonwealth has a controlling interest;
- to affirm the Auditor-General's authority to initiate efficiency audits of all Commonwealth instrumentalities;
- to place beyond doubt the Auditor-General's authority to contract audits to whom he or she considers appropriate;
- to simplify statements of the Auditor-General's authority in relation to regularity and performance audits;
- to rename the Australian Audit Office (see below); and

to reaffirm the role of the Independent Auditor of the Australian Audit Office in light of these legislative changes.

18.2 There is a further reason for new legislation:

to provide the Australian Audit Office with a clearer definition of its role in government.

Role of the Australian Audit Office

18.3 The Audit Act 1901 defines the responsibilities of the Auditor-General to include¹:

appointment of persons to inspect, examine and audit any accounts, records or stores required by the Act or other relevant legislation. Such persons must report the results of such work to the Auditor-General, (section 11). These persons have the same powers of inspection as the Auditor-General;

appointment of persons to conduct efficiency audits;

reporting to the minister for the audited department or authority on matters arising out of the exercise of his powers (section 12); and

reporting significant matters from efficiency audits to the Prime Minister, the Minister for Finance as well as to the minister responsible for the audited department or authority.

18.4 The Auditor-General is granted extensive powers:

to require persons to appear personally before him and to produce accounts and records the Auditor-General deems necessary, (section 13);

to search records in the custody of ministers and other persons in public office; and

to have access to any accounts and records he deems fit (section 14B).

1. Chapter 2 of the AAO Submission to this inquiry contains a complete list of the Auditor-General's functions.

18.5 References to the Audit Office are made under the following sections of the Act²:

2. 'Auditor-General's Office' means the branch of the Australian Public Service under the direct control of the Auditor-General.

11. The Auditor-General may, ...

(a) appoint a person to inspect, examine and audit any accounts, records or stores which are required by this Act.

48K(1). 'The Minister may...make arrangements with a suitable person... to exercise the powers and perform the functions of the independent auditor.'

(2). ...the functions of the independent auditor are -

(a) to carry out audits of the accounts and records kept... in relation to the Auditor-General's Office.'

18.6 The Audit Amendment Act 1988 referred to the Australian Audit Office by name for the first time.

18.7 In comparison, the National Audit Act 1983, which was drafted after a major revision of audit legislation in the United Kingdom, refers throughout to the National Audit Office, NAO, which is the equivalent of the AAO³.

18.8 The AAO stated that the role of the AAO followed the role of the Auditor-General. The AAO defined its role as improvement of⁴:

the economy;

efficiency; and

2. Audit Act 1901.

3. National Audit Act 1983, op. cit., section 3.

4. AAO Submission, op.cit.,p.19.

accountability of the Commonwealth public sector through comprehensive auditing of the executive and its agencies and through reporting on audits.

18.9 The Department of Finance agreed with the AAO on its role, affirming that the AAO's Corporate Plan reflected its mandate. DOF accepted that the latter was exercised through:

undertaking comprehensive auditing of the executive and Commonwealth agencies;

reporting to ministers and the Parliament and assisting Parliamentary committees.

18.10 There was no clear path from legislative descriptions of the role of the Auditor-General and the AAO, to the interpretation of the Audit Office's role agreed to by the Audit Office and the Department of Finance. Of note was that the Public Accounts Committee was attracted to the objectives stated in the Audit Office's Corporate Plan despite the Audit Act's circumspect definition of the Office's role. In fact, nowhere did the Act state the Audit Office's role as expressed in the Audit Office's Corporate Plan. The latter had outstripped legislative statements on what the AAO should do.

18.11 A separate consideration was the relationship between auditing standards devised by the auditing and accounting profession, and called Australian Audit Standards, and accounting standards that the Audit Act requires the Auditor-General to devise (section 63MB). A modern audit act is necessary to require the Auditor-General to carry out his duties in accordance with Australian Audit Standards, except where the AAO's standards address issues inadequately covered in Australian Audit Standards. This requirement reflects the Auditor-General's current practice. The Auditor-General's audit standards should neither be lesser nor narrower than Australian Audit Standards, and they should properly reflect the responsibilities of public sector auditors.

18.12 The Committee recommends that:

The Audit Act 1901 be rewritten to clarify the role of the Auditor-General and his Office.

18.13 The significance of many recommendations in this report is so great that they will provide the Audit Office with an opportunity for a new beginning. To indicate the break with the past, the Committee believes that the Australian Audit Office should be renamed as the Australian National Audit Office.

18.14 The Committee recommends that:

The Australian Audit Office be renamed the Australian National Audit Office.

The Audit Act's Two Purposes

18.15 The preamble to the Audit Act 1901 states that it is:

An Act to make provision for the Collection and Payment of the Public Moneys the Audit of the Public Accounts and the Protection and Recovery of Public Property and for other purposes.

18.16 The Act provides a legislative basis for:

the financial management and administration of Commonwealth sector organisations and programs; and
the audit of those organisations and programs.

18.17 Table 18.1 indicates how some parts of the Act deal with financial management and others with audit. Other parts combine the Act's two purposes. For example, Part XI, section 63D(1) states that:

The (public) authority may open and maintain an account or accounts with an approved bank or approved banks and shall maintain at all times at least one such account....

18.18 While section 63G(1) affirms 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,...

TABLE 18.1

Principal Provisions of the Audit Act 1901

<u>Part</u>	<u>Heading</u>
i	Preliminary
ii	The Auditor-General
iii	Accounting Officers
iv	Collection of Moneys and Securities
v	Payment of Moneys
vi	Audit and Inspection
vii	Statements and Their Audit
viii	The Loan Fund
ix	The Trust Fund
x	Moneys Outside Australia and Naval Expenditure
xi	Financial Provisions Relating to Public Authorities and Certain Other Bodies
xii	Penalties
xiii	Miscellaneous

18.19 Consequently, the current Act is ill-named being more accurately titled the Financial Administration and Audit Act⁵.

18.20 In comparison, both the United Kingdom and Canada have separate financial administration and audit acts⁶. The above preamble to the Australian Audit Act 1901 can be compared with the preamble to the British National Audit Act 1983 which affirms:

An Act to strengthen Parliamentary control and supervision of expenditure of public money by making new provision for the appointment and status of the Comptroller and Auditor-General, establishing a Public Accounts Commission and a National Audit Office and making new provision for promoting economy, efficiency and effectiveness in the use of such money by government departments and other authorities and bodies...

18.21 In Australia the Department of Finance is responsible for drafting regulations and directions under the Act. Government organisations are required to abide by these, while it is the work of the Auditor-General to determine to what extent this has been done. In this task, the Auditor-General can claim he has little, if any, involvement in drafting the regulations and directions which executive departments and authorities have responsibility for implementing. This division of responsibility between the Department of Finance and the Audit Office is not always clear to auditees. The latter often claim that the Audit Office gives too much attention to auditee adherence to Finance Regulations and Directions which are impediments to efficient administration. The Audit Office's reply is that it has a statutory obligation to implement the Audit Act and to ensure that the Act's regulations and directions are followed. Of relevance is that only 27 per cent of AAO resources are allocated to the audit of Commonwealth agencies bound by Finance Regulations and Directions⁷.

18.22 There is a widely shared perception by auditees that Finance Regulations and Directions do not always promote efficient and economic administration. Hopefully, such reservations apply to a minority of provisions. The Committee urges that the DOF give more attention to communicating the

5. Acknowledgement of the dual functions of similar legislation is in the title of one of the more recent examples of State government legislation, the Financial Administration and Audit Act 1985 of Western Australia.

6. In the U.K., these are the National Audit Act 1983 and the Exchequer and Audit Departments Act(s). Canada has the Auditor-General Act 1977 and a Financial Administration Act.

7. AAO Submission, May 1988, op. cit., pp.62-63.

purposes of the regulations and directions to agencies to which they apply, and to increasing the rate of revision of those provisions to ensure a sharper focus on efficient financial administration.

18.23 Since the authority to make such revisions rests with the DOF, many criticisms of the AAO have been misplaced. This is one reason for splitting the current Act into two pieces of legislation, a Financial Administration Act and an Audit Act. Such division would demonstrate more clearly that responsibility for modernisation of Finance Regulations and Directions was the Department of Finance's responsibility. Thereafter, the Audit Office should be subject to less criticism.

18.24 The Committee recommends that:

The Audit Act 1901 be repealed, and be replaced by two new laws, a Financial Administration Act and an Audit Act.

18.25 Legislative change would not be sufficient to transform the Audit Office's image. Two other changes are necessary for that purpose. The first change arises from DOF dissatisfaction with the Audit Office's lack of participation in revisions of Finance Regulations and Directions. According to the DOF, the Audit Office was in a unique position to comment and advise on Regulations and Directions through its scrutiny of records and procedures in every portfolio. DOF welcomed a strong Audit Office involvement in revisions of Regulations and Directions. DOF also believed that the AAO was not more deeply involved because of fear that it would compromise its independence if these were changed and the Audit Office commented on later implementation of those changes.

18.26 The Audit Office participated in a working party on revision of Finance Regulations and Directions, and it had advised on these in other circumstances. Nevertheless, the Committee believes that the Audit Office could use its strategic position to greater advantage in providing advice on revisions of Regulations and Directions, for example, from a cost-benefit perspective. This would mean that the Auditor-General would utilise section 54 of the Act more often. Section 54 states that:

The Auditor-General may ...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 moneys and stores, and such plans and suggestions shall be considered and dealt with by the Ministers.

18.27 Clearly, the Audit Office has interpreted this section of its Act excessively narrowly.

18.28 The second change would require the Audit Office to be seen more often by auditees to be balancing its concern with implementation of the Audit Act (through commenting on adherence to Finance Regulations and Directions) with a concern with efficient public sector management. Some auditees have criticised the Audit Office for a lack of balance in these matters. Of course, where the Regulations and Directions are both written and interpreted to allow maximum organisational efficiency, the question of balance is already answered. Yet application of certain Regulations and Directions to particular kinds of decisions in some auditee organisations may lead to the adoption of less efficient means of operation.

18.29 Resolution of this 'choice' between pursuit of maximum accountability and maximum efficiency can explain many management decisions. Auditee criticisms of the Audit Office suggested that managers were doubtful of the Audit Office's appreciation of the dilemmas they confronted in ensuring that both public service accountability and efficiency were maintained. No auditee suggested that the Audit Office should turn a blind eye to the Audit Act. However, there were suggestions that in interpreting adherence to the Act the Audit Office should also draw attention to the efficiency implications of the financial or other procedures which were being examined.

18.30 Greater attention to the efficiency aspects of audited administration would require the Audit Office to consider the perspectives of management without diminishing the importance of upholding the client's, that is, Parliament's, concerns. An irony was that Auditors-General have complained in recent years about reductions in the numbers of performance audits. In the situation described here, auditee management stressed that it would like the Audit Office to provide more comments on efficiency aspects of financial administration in ways which would have minimal impact on the demand for Audit Office resources.

Chapter 19

CONCLUSION

19.1 It will be remembered that the inquiry's terms of reference were to investigate:

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

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

19.2 The Committee has answered with a conditional no to the first question, and no to the second question. The most important reasons for this situation were outside the Audit Office's control.

19.3 At the commencement of this inquiry, at a minimum, the AAO could be described as having major problems. At a maximum, the AAO was in a state of crisis. Its problems included:

a bare adequacy of resources for regularity audits and insufficient resources for performance audits;

discrepancies between performance audit legislation and resources. This was suggested by how the AAO allocated the smallest percentage of resources to performance audits of all comparable national audit offices. No good reason was given to the Committee for the continuation of this situation;

the AAO's most important auditee was the principal advisor on the AAO's resources, compromising the former's independence;

loss of major auditees;
loss of experienced staff at all levels; and
an image problem within the accounting profession.

19.4 These problems were so noticeable and severe that they demanded an explanation. In the Committee's view, they had developed for the following reasons:

parliamentary complacency. Parliament had been well served by the Audit Office since Federation. The quality and length of service had led to a dulling of Parliament's capacity to perceive that the AAO had difficulties, and perhaps to disbelief that the AAO could ever have major problems;

the Auditor-General and his Office fell between two stools, the legislature and the executive. His almost unique freedom from political control coupled with ambiguous relations with executive government led to parliamentary and governmental neglect. Considering the confusion over whether he was an officer of the executive or the legislature, neither appeared enthusiastic about claiming responsibility for the Office's condition. This was an unfortunate consequence of his independence;

there were no mechanisms in place to permit Parliament to assume responsibility for the AAO;

until very recently, the AAO gave a higher priority to the economy of its operation than to reappraising its contribution to government. This report has argued that the AAO must attend to both concerns. A better understanding of the possibilities of auditing in government will be a result; and

lack of public awareness of the importance of government audit.

19.5 The Committee has suggested solutions to the AAO's problems. The solutions include:

reaffirmation of the necessity of the Auditor-General being free of political control;

a new Audit Act. This was necessary to establish the Auditor-General as an officer of the Parliament and to affirm the Audit Office's service role to Parliament, to establish the Audit

Office as a statutory authority, to give the Auditor-General the authority to determine the terms and conditions of employment of staff, and, amongst other objectives, to indicate for which Commonwealth agencies he was the external auditor;

establishment of an Audit Committee of Parliament to permit better parliamentary scrutiny of the AAO's estimates and to pursue a general oversight role of the AAO on Parliament's behalf;

a major increase in funding for performance or efficiency audits. In 1987-88, \$1m. was allocated to the efficiency audits of government programs which had a combined value of \$84b. A major increase was warranted to develop the current marginal contribution of efficiency audits to improvements in public sector management; and

encouragement of competition between the AAO and accounting firms. This competition will encompass audit productivity, methodology and technology.

19.6 New legislation and formation of the Audit Committee of Parliament are immediate necessities. The funding increase should be staged over five years to permit the Audit Office time to consolidate. The result of these directions for change will be to affirm the AAO's leadership in public sector audit, nationally and internationally. Ultimately, acceptance of recommendations in this report will mean an acceleration of moves to make government both more accountable and more efficient, as well as more responsive to taxpayers.

19.7 Presently the Commonwealth sector is a world where economists reign, and where attention is on large-scale policy choices. Success in developing the best administrative machinery to implement political choices is uneven. The public sector is in need of microeconomic reform such has occurred elsewhere. The Audit Office has made a contribution to improving productivity in that sector and should continue to contribute.

19.8 A good deal of this report focused on sorting out who was the Auditor-General's client, and also with encouraging the Auditor-General to balance differently than in the past the interests of the client, who is Parliament, and auditees. Although Parliament is the Auditor-General's client, it is ironic to consider that few Parliamentarians know much about the Australian Audit Office or even where it is located. The issue of the Audit Office's location is timely since the Audit Office has been compelled to move from its central office in Canberra because of structural problems in the rented building. A new location must be found. Consistent with the report's concern with strengthening the links between Parliament and the Audit Office, there is a final recommendation.

9.9 The Committee recommends that:

The Australian Audit Office plan for a new building either within the Parliamentary Triangle or on State Circle adjacent to the new Parliament House, and that the building be called Audit House¹.

R E Tickner, MP
Chairman
9 March 1989

1. 'The building selected for locating the central staff and myself is situated in Swanston Street, Melbourne, and is some distance from all other Commonwealth offices, no other suitable premises nearer to the latter having been found'. This extract from the first annual report of an Australian Auditor-General in 1902 suggests that some problems take a long time to solve: Report of the Auditor-General for the Commonwealth upon the Treasurer's Statement, op.cit., 1902, p.128.