



30 January 2014

Ms Lyn Beverley
Secretary
Senate Select Committee
PO Box 6100, Parliament House
CANBERRA ACT 2600

Dear Ms Beverley

Inquiry into the Abbott Government's Commission of Audit

Thank you for your letter of 14 January 2014 inviting the Australian National Audit Office (ANAO) to make a submission to the Committee's inquiry into the Abbott Government's Commission of Audit.

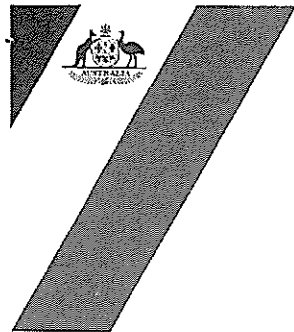
The ANAO has made a submission to the Commission of Audit, a copy of which is attached. We made this submission publicly available via our website shortly after it was provided to the Commission.

As noted in the submission, the ANAO has a particular interest in a number of the Commission's Terms of Reference, and looks forward to the Commission's reports should they be made publicly available.

Yours sincerely

Ian McPhee

Auditor-General for Australia



22 November 2013

Mr A F Shepherd AO
Chair
National Commission of Audit
John Gorton Building
King Edward Terrace
PARKES ACT 2600

Dear Mr Shepherd

Australian National Audit Office Submission

Thank you for your letter of 6 November 2013 inviting the Australian National Audit Office (ANAO) to make a submission to the National Commission of Audit.

The ANAO is responsible for auditing the financial statements of all Commonwealth owned and controlled entities and has the authority to conduct performance audits of these entities, with the exception of Government Business Enterprises that require a request from the Joint Committee of Public Accounts and Audit (JCPAA). The ANAO may also undertake audits of Commonwealth Partners which include state and territory bodies that receive Commonwealth funding for a particular purpose, where such an audit is requested by the responsible Minister or the JCPAA.

In discharging our responsibilities to the Parliament, we gain an insight into the state of public administration and make recommendations for improvement in the context of existing legislative and policy settings. As you will be aware, the ANAO's remit does not extend to commenting on the appropriateness of specific government policies.

Background

By way of background, it is important to recognise that public sector administration has become more business-like in the last 25 years, with broad support across the parliamentary spectrum. Over the years we have seen devolution of authority to line agencies from central agencies, a stronger focus on governance and risk management, variations to legislative budgetary and administrative frameworks designed to achieve

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a stronger focus on outcomes, accrual budgeting and accounting to provide better information for decision making, some consolidation of public sector bodies, and a stronger people focus – the goal being stronger performance by the public sector and a stronger accountability regime. While the changes are generally viewed as being incremental, some periods have been more intense than others; and, occasionally, the reform pendulum has swung too far, requiring subsequent recalibration.

A study by the OECD in 2012 commented that Australia had, in the 1990s, gone further than any other of 12 leading OECD countries in the implementation of New Public Management reforms; and that Australia has benefited more than other countries from the positive results of these reforms. Reference was made to Australia's budgeting processes (top down, medium term expenditure framework, generally effective Cabinet committee processes, seeking offsetting savings for new initiatives), the outcome focus in budgeting, accrual accounting, and a trend to more horizontal and vertical integration. There were, however, some negative consequences of the reforms in Australia which the study suggested needed to be rebalanced, including:

- a more consistent division of tasks between levels of government: by demarcating domains of service provision in which the states are the primary responsible layer of government from domains in which the Commonwealth government is the primary responsible layer of government;
- vertical integration: better use of executive and professional expertise in policy development;
- horizontal integration: process sharing among agencies and the merging of agencies; sharing of support services or the merging of support service units;
- stricter standards of operational management, as currently differences across agencies in terms of support services make it difficult to move quickly to establish shared service arrangements;
- separation of financing of agencies (which can be based on rules for the fixed and variable costs of the agency's required production capacity in light of the estimated needs for its services) from steering and control of outputs.¹

These observations by the OECD are directed to the various government-wide frameworks and arrangements that influence public sector performance.

While there is certainly scope for improvement in Australian Government public sector administration, the public sector is working from a reasonable base. Our audits show that governance and financial reporting arrangements in the public sector have improved over the years. However, our audits also show the risks to effective

¹ OECD, 2012. *Value for Money in Government: Australia 2012*. OECD Publishing. p.12

administration increase significantly in a range of circumstances including in the implementation of new initiatives under time pressure, or in situations where the integration of technology and other components are central to revised delivery arrangements or acquisitions, or where more than one agency is involved in program delivery (including cross-jurisdictions). Further, there is insufficient focus by agencies on measuring the efficiency and effectiveness of government programs, and insufficient encouragement to perform better.

In considering the National Commission of Audit's terms of reference and issues evident from our audit coverage, there are five priority areas that we would highlight for your consideration.

Priority areas for attention in public administration

Agreements between the Australian Government and the States and Territories

The ANAO's work in recent years has included a number of performance audits that have reviewed the administration by the Australian Government of a number of National Partnership Agreements (NPAs). Our financial statements audits of relevant entities also include a review of the systems and processes that support National Partnership payments to States and Territories. Our work in this area has identified there is a need to improve the way performance in achieving the agreed outcomes specified in individual agreements is measured and reported.

In particular, in a number of agreements reviewed:

- there was a focus on measurement of activities rather than outcomes or reform objectives;
- there was a lack of clarity of the respective roles and responsibilities of Commonwealth entities in administering agreements; and
- the design of funding and reporting arrangements did not support an assessment of whether reforms to service delivery were being progressed or achieved.

Our audits have also identified that:

- while the Intergovernmental Agreement contains broad objectives in relation to public accountability and performance reporting, there is a wide variation in the accountability and reporting arrangements specified in individual agreements;
- the terms of individual agreements generally did not provide for information required under NPAs to be advised by the States and Territories, where significant, to be subject to independent assurance or verification;

- while agreements generally provided the authority for Commonwealth agencies to seek clarification or obtain additional information from the States and Territories, agreements generally did not include provisions that allowed the Commonwealth to obtain independent assurance on the accuracy and completeness of information submitted from the States and Territories; and
- in the small number of cases where agreements provided the Commonwealth with the authority to have direct access to information and records maintained by the States and Territories, the relevant agency generally did not utilise these provisions.

These issues are consistent with a number of the findings outlined in the recent COAG Reform Council Report *Lessons for federal reform: COAG reform agenda 2008-2013*.

The ANAO is aware that there are over 100 National Partnership Agreements in place, covering a broad range of areas of service delivery. Inherently, this situation involves a considerable level of administration by both the Commonwealth and the States and Territories, and it is timely to assess whether existing arrangements are the most cost-effective way to achieve the outcomes expected.

More broadly, the ANAO recently tabled its first audit involving a Commonwealth partner, utilising the new powers given to the Auditor-General by the Australian Parliament. The focus of the audit was on the administration of agreements between the Commonwealth and Tasmania relating to the management, operation and funding of the Mersey Community Hospital (the Mersey). This audit allowed the arrangements between governments to be analysed from end-to-end.

The audit highlighted that Commonwealth ownership of the Mersey has resulted in the need to establish unique arrangements for its management and operation, which have come at additional complexity and cost to the Commonwealth (some \$367 million over six years in hospital funding and a further \$14 million in administrative overheads for the Department of Health) compared to the standard model of funding public hospitals through health care agreements. While the audit related to a single hospital, there are wider lessons here about the risks and costs potentially arising from ad hoc arrangements. Further, and notwithstanding the Commonwealth's ownership and funding of the Mersey, Tasmania has successfully continued to advance its strategic health agenda for the region, in the context of State control of the hospital system. The ANAO also undertook a comparative analysis of the Mersey's relative efficiency compared to comparable mainland and Tasmanian hospitals; observed that Commonwealth ownership has not been subject to value for money analysis; and essentially put to rest a number of persistent allegations about the misuse of Commonwealth funding provided under the agreements.

The ANAO's conduct of the first Commonwealth partner audit was considered to be 'professional and sensitive' by the relevant Tasmanian agencies, and the decision to audit the Mersey – a hospital of undoubted interest to the Commonwealth given the

ownership and funding arrangements – reflected my undertaking to the States and Territories that follow-the-money powers would be used judiciously.

Measuring the effectiveness of government programs

In a similar vein, the ANAO considers there is considerable scope to improve the way the Commonwealth assesses whether program outcomes or the impacts sought by government are being met. The Commonwealth lacks a coherent and structured performance and administration framework that informs government, when making key policy judgements, on how well program outcomes and objectives are being achieved and how efficiently and effectively the public sector is performing. The ANAO's work in the area of performance measurement and reporting has consistently demonstrated over a number of years that many Commonwealth agencies have fallen short in developing and reporting performance measures that demonstrate the achievement of stated program or activity objectives. In addition, the evaluation of programs is uneven and there is no central policy or guidance that assists individual entities in their conduct.

It is clear that there has been insufficient commitment and investment in designing, implementing, and promoting a performance framework that: takes into account the diverse nature, scope and size of government programs and activities; provides governments including decisions about reporting future program expenditures, with reliable and useful performance information; and involves the reporting of relevant information to the Parliament on government performance over time.

The ANAO is aware that some steps have been taken to address this situation including the requirement in the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) for the accountable authority of a Commonwealth entity to measure and assess its performance, and to include an annual performance statement in its annual report (see sections 38 and 39 of the Act).

Nevertheless, much more needs to be done to operationalise this requirement and ensure that these requirements result in a tangible and demonstrable improvement when compared with existing arrangements. To shift the focus much more strongly from dollars and outputs to impacts will require a sustained commitment from government, central agencies, and individual entities. It is an essential step, however, to maximise the benefits from the Government's investment in policies and programs, and drive public funding further.

In the longer term, once an enhanced performance reporting regime has been established, entity performance information should be subject to audit on a regular or other agreed basis. The *Auditor-General Act 1997* currently provides for the audit of Key Performance Indicators, but due to the limitations of the current framework (and

resourcing of the ANAO, which would need to be separately addressed), only pilot exercises have been conducted and reported.²

Grants administration

A major function of the Commonwealth Government is the provision of grants to a wide range of government and non-government bodies, organisations and individuals. The precise number and value of grants made by the Commonwealth Government in any one year is difficult to establish as details are contained in individual entity documents. The cost of grants administration is also not known, as these costs are not generally separately identified. Nevertheless, it is fair to say that total grants expenditure in any one year is many billions of dollars, many thousands of grants are made by the Commonwealth, and the administrative costs associated with grants is considerable, representing a sizeable amount in some agencies' departmental budgets.

The ANAO's audit coverage of agencies' grants administration, that is undertaken in the context of legislative and government policy requirements existing at the time, have identified the importance of grant programs being implemented in a manner that accords with published guidelines. In this respect, the grants administration framework was developed, based in part on the recognition that potential applicants and other stakeholders have a right to expect that funding decisions will be made in a manner, and on a basis, consistent with the published guidelines. The ANAO has tabled a range of audit reports and issued a Better Practice Guide *Implementing Better Practice Grants Administration* to assist agencies to achieve better outcomes by improved administration of grant programs.

From a policy perspective, the increasing number, value and diversity of grants coupled with the cost of administration for both the Commonwealth and grant recipients, suggests there would be tangible benefits in a periodic assessment of the range of grants programs to provide confidence that they are consistent with the Government's strategic policy objectives, and being managed efficiently.

Rationalisation of Commonwealth entities and compliance and reporting obligations

While noting that decisions to create new entities are matters for government and the Parliament, the ANAO supports initiatives to better manage entity numbers, particularly small entities in view of the disproportionate administrative costs associated with these entities. In some cases at least, smaller entities have difficulty in applying resources to meet legislative and policy requirements, including financial management requirements. The ANAO therefore considers there is merit in government periodically reviewing entity numbers against criteria developed through appropriate consultation. The growing trend of portfolio departments providing administrative support for smaller entities, where these arrangements are mutually agreed, is also to be encouraged.

² See ANAO Report No 28 2012-13 *The Australian Government Performance Measurement and Reporting Framework*. A further report is expected to be tabled in the first quarter 2014.

The current debate on removing red-tape and the compliance burden is timely as it is well accepted that there are costs to industry and the community, as well as to government, from the accumulation of compliance measures. The ANAO is supportive of the need for review while at the same time recognising that sound judgement is required to achieve the right balance between maintaining necessary controls and undue prescription.

The publication by entities of audited financial statements is a strength of the existing financial management arrangements. However, there is scope within the existing accounting standards framework for the financial reporting obligations on individual entities to be reduced. Currently, the Commonwealth adopts a largely one-size-fits-all approach to financial reporting that results in a considerable amount of disclosure in entities' financial statements, all of which arguably is not necessary to meet entities' financial reporting obligations. The adoption by the Australian Government of AASB 1053 *Application of Tiers of Australian Accounting Standards*³ and a more rigorous application of the concept of materiality would reduce the financial reporting burden, while still providing appropriate accountability to the Parliament.

Assessing financial performance and sustainability

One of the strengths of the existing financial framework is the preparation and audit of annual financial statements by all Commonwealth entities that are included in each entity's annual report tabled in the Parliament. The Australian Government also publishes audited whole-of-government financial statements, the Consolidated Financial Statements (CFS). The publication of these financial statements provides a high level of transparency in respect of the Australian Government's financial performance and position, informs government decision-making and provides the basis for the Parliament to hold the Government to account. To assist the Parliament obtaining a better appreciation of the financial position of all entities that are material in the context of the CFS, the ANAO analyses the operating results and examines the balance sheet position of these entities. The results of this work are included in the ANAO's report that reports the results of the audit of the financial statements of Australian Government Entities.⁴

The benchmarks developed by the ANAO as the basis of this work are quite limited and have been developed in the absence of any benchmarks or targets established by government. Overall, the ANAO analysis, which is confined to an analysis of entities' audited financial statements, suggests that individual material entities are effectively managing their financial position within the context of existing budget and financial reporting parameters. A tightening budget environment is likely to affect this situation in future years.

³ This standard outlines two tiers of reporting requirements that apply to different types of entities.

⁴ See Audit Report No 16 2012-13 *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2013*, pages 11 to 55

To provide a greater focus on the financial performance of entities and the Australian Government, the ANAO considers there would be merit in government developing and reporting on financial performance targets or benchmarks and measures of sustainability so that the Parliament and public are better informed on these issues. Such measures could be subject to audit as a complement to the current financial statements audits undertaken by the ANAO.⁵

Effective public administration essential for good government

Over the last 30 years, the public sector has been an early adopter and adapter of change and technology, but it needs ongoing encouragement from ministers and key central agencies to maintain the momentum to drive public funding further, achieve better outcomes and build greater resilience in communities. Essentially, these goals rely on the fundamental importance of government respecting the value of public funding. Drawing from national and international developments, means to achieve this end may include a renewed focus on contestability of service provision, the adoption of sound business approaches, and reinforcement of the benefits of a strong performance orientation.

There is also a need for public sector entities to maintain, indeed strengthen, organisational capability that will allow the impact of government policies to be assessed and policy options for the years ahead to be shaped, along with the ability to plan, resource and prioritise effort. There is also a need to continue to invest in leadership and staff development in a way that creates the conditions that encourage innovation and a focus on performance in the delivery of policies and services.

For its part, the ANAO seeks to maximise the impact of its work by reinforcing the importance of public administration being outcomes orientated and underpinned by sound systems and controls that are designed to deliver sustained and effective performance. We encourage entities to use ANAO reports, and its suite of Better Practice Guides on key aspects of public administration, as benchmarks for improving performance.

The ANAO's financial statements audits provide the Parliament, the Government and the community with independent assurance about the financial performance of Australian Government entities, and through our performance audits we provide an independent source of sound information and advice to the Parliament on the state of public administration and programs funded by the Australian Government. In addition, for a comparatively small organisation, the ANAO continues to make a strong contribution to the international public sector audit fraternity and contributes directly to improving the work of our counterparts in Indonesia and Papua New Guinea.

⁵ The Commission's attention is drawn to the United Kingdom Government's recent endorsement of the Financial Management Model of the Chartered Institute of Public Finance and Accounting (CIPFA). The UK National Audit Office had developed and applied a Financial Management Maturity Model until the Government announced that the CIPFA model was to be adopted.

I would be pleased to discuss with the Commission these and any other matters that may be relevant to your terms of reference.

Yours sincerely

Ian McPhee
Auditor-General