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REPORT BY THE JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT ON THE 2008-2009 DRAFT ESTIMATES FOR THE AUDIT OFFICE

I rise on behalf of the Joint Committee of Public Accounts and Audit to report on the draft budget estimates of the Australian National Audit Office. This is a requirement of the *Public Accounts and Audit Committee Act 1951*, and reflects both the Committee's status as the Parliament's audit committee, and the Auditor-General's status as an independent officer of the Parliament.

The Audit Office's revenue from government in 2007-08 was $63.4 million. The Auditor-General has advised that estimated revenue from government for 2008-09, excluding some new funding to audit major Defence acquisitions, will be just under $62 million. This includes the 3.25 percent efficiency dividend being applied to all public sector agencies in this year's budget.

The Auditor-General advised the Committee that he had sought additional funding in the 2008-09 budget of some $13.7 million over five years, with an ongoing amount of $2.9 million annually. This funding was to be applied in three areas. First, the Audit Office sought $6.5 million to conduct an annual review of major Defence capital equipment projects.

By way of background, my Committee recommended in late 2006 that the Audit Office be funded to annually review progress in major Defence capital equipment projects, in a manner similar to a review conducted by Great Britain's National Audit Office. This recommendation arose from the Committee's inquiry into financial reporting and equipment acquisition at the Department of Defence and Defence Material Organisation, following a series of critical reports by the Auditor-General on individual projects.

The recommendation made by the Committee was similar to one previously made by the Senate, and which the Audit Office had unsuccessfully sought funds for in previous budgets. We made this recommendation because we believed there would be considerable benefit from ongoing early review of Defence equipment acquisition projects, and that the modest funding sought by the Audit Office should be considered in light of the substantial savings that may accrue from better management of these capital projects.

I am pleased that the Government has agreed to provide $1.5 million annually to the Audit Office, from 2009-10 onwards, to conduct the Defence capital equipment projects report, with initial funding of $750 000 in this year's budget.

The Committee notes that the Audit Office has not received the full $1.5 million it had sought in this year's budget, nor has it been reimbursed $500 000 in funds it had sought towards the funds it spent on preparatory work in 2007-08. However, the funding that has been provided will at least enable the Audit Office and DMO to proceed with confidence on this annual process. The Committee looks forward to reviewing a trial report on nine Defence projects, which is likely to be tabled later this year.

The Audit Office also sought just over $6 million over four years, and $1.4 million ongoing annually, to audit more comprehensive government financial reporting following the introduction of a new accounting standard. In brief, the new standard creates a different reporting framework for the Australian Government from the 2008-09 financial year onwards. Amongst other things the standard provides for the preparation, and audit, of General Government Sector statements. This will be the first time that such statements have been audited. The new standard aims to achieve a single set of government reports which are auditable, comparable between jurisdictions, and directly comparable to relevant budget statements.

While these are welcome developments, the Audit Office has not received any additional funding to undertake its statutory obligations in relation to the new standard. There will be a significant increase in audit workload arising from the new General Government Sector financial statement, and the Audit Office will need to become skilled in auditing statements incorporating information which was not previously required.

The Audit Office also sought a one-off amount of just under $1.1 million for additional work resulting from the abolition of four government Departments in December 2007. The *Financial Management and Accountability Act* requires that financial statements be prepared for the former Departments, so that there is an appropriate accounting for their functions. The Audit Office had therefore sought funding to conduct "close down" financial statement audits for the abolished Departments.

While this request was unsuccessful, the Committee notes that the Department of Finance has proposed that the abolished Departments be dealt with in the notes to the financial statements for those Departments that have taken over the relevant functions, rather than separate "close-down" statements for the former agencies. The impact on the Audit Office's budget might therefore not be as great as feared, but the Auditor-General will monitor the situation and may seek additional funds if necessary.

Finally, and most importantly, the Auditor-General also wrote to the Government to propose that the Audit Office's funding be placed on a more sustainable long-term footing, by indexing its budget to the rate of growth in the public sector. This reflects the reality that growth in the Audit Office's resource base has lagged well behind growth in the public sector over the past decade. Between 1998-99 and 2007-08 the Australian Government's combined revenue and expenditure increased by 49.5 percent in real terms. In the same period, the Audit Office's expenditure on financial statement auditing increased by only 11.5 percent in real terms, while spending on performance auditing actually decreased by 4.5 percent in real terms. This mismatch obviously challenges the Audit Office's capacity to provide comprehensive oversight of the public sector.

In the interim, the Auditor-General put forward a short-term proposal to adjust the Audit Office's funding by $5 million over four years, which would have effectively negated the additional two percent efficiency dividend applied in this year's budget. This funding would have been directed to continued development of the Audit Office's Better Practice Guides, and a continued focus on areas it has previously identified, through its performance audits, as having a strong flow-on benefit for public sector administration, in particular contract and project management.

The Committee notes that these proposals for a more sustainable long-term funding base have not been supported at this time. The overall impact of these decisions on the Audit Office has been a 3.25 percent reduction in base funding, in addition to being obliged to absorb the significant new audit responsibilities I mentioned earlier.

The Auditor-General has advised that he has taken steps to limit the impact of the budget reduction, including closely reviewing the Audit Office's corporate expenditure on a line-by-line basis. Despite this, the budget reduction will limit the Audit Office's capacity to deliver to the same level in its audit work. This will be reflected in the following ways:

- First, the Audit Office's capacity to conduct detailed checking in its annual audits of agencies' financial statements will be reduced, at a time when new accounting standards are being implemented. The Audit Office will instead look to a multi-year view for system assurance where appropriate; it will place more reliance on management assurance processes within the audited agency; and it will limit any growth in its IT audit capacity.

- Second, the number of performance audits and Better Practice Guides the Audit Office can produce will also be reduced. The target for performance audits has been reduced from 51 to 45 for 2008-09, while the annual target for Better Practice Guides has been reduced from four to three.

These budget pressures come at a time when the Audit Office is facing staff turnover in excess of 25 percent due to high demand for the accounting and auditing skills possessed by its staff; price pressures – including for contract audit services – greater than the indexation levels applied to its resource base; and limited cash reserves. The Committee notes advice that the Audit Office will invest modestly in staff learning and development, and systems and methodologies, to ensure that it develops its staff and is able to continue to produce high-quality work.

To the extent that the Auditor-General's direct appropriation for 2008-09 is sufficient for him to discharge his statutory responsibilities, we endorse the budget proposed for the year ahead. However this endorsement comes with significant reservations.

As I have noted, the proposed budget will necessitate a reduction in the Audit Office's discretionary audit work program. While the Audit Office will of course design its work program to fit within available resources, we do not believe that the Parliament is well-served by this.

The Committee believes that the Audit Office cannot continue to consistently deliver the outcomes expected of it by the Parliament, the Australian community and its agency clients on its existing funding base. Going forward, it is imperative that we reach agreement on a long-term sustainable funding model, given the importance of the Audit Office being progressive in its approach to its audit role. Both the Auditor-General and I have written to the Prime Minister on this matter.

The Audit Office is the front line in ensuring government accountability and probity, and in creating an environment where corruption has limited opportunity to arise. In the Committee's experience, the modest budget of the Audit Office should be seen as a cost-effective mechanism for curbing waste and excess, and identifying areas for better administration on behalf of the Parliament and the Australian community.

I present a copy of my statement.

Sharon Grierson MP
Committee Chair

13 May 2008