

AUDITING IN A CHANGING GOVERNANCE ENVIRONMENT

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INTRODUCTION

The Australian National Audit Office (ANAO) is pivotal to the system of checks and balances that support democracy in Australia. Public reports from an independent Auditor-General ensure that the Parliament, and beyond it the Australian citizenry, has a degree of assurance in relation to the proper administration of Commonwealth resources. The ANAO has a dual role in terms of reporting on the financial management and overall performance of the public sector. Our first aim is to provide independent assurance. This is the more traditional ‘watchdog’ audit role. Our second role is to suggest improvements to public administration. Increasingly, it is this second, advisory role that is most important for a public sector which, in the proper pursuit of greater efficiency and effectiveness is challenged by diverse governance issues which are growing in complexity.

A responsive relationship with the Parliament is integral to the ANAO’s ability to continue to deliver products that add value in the contemporary public sector environment. The notion of getting the mix right to provide adequate assurance and suggest improvements in administration highlights the symbiotic nature of our relationship with the Parliament. The success of the relationship depends on its ability to support, and reinforce, frank and open dialogue on trends challenging public sector accountability in the Commonwealth context.

For example, recent corporate collapses in the private sector are again leading to calls for strengthened internal and external control and scrutiny. Although not driven by the same imperatives, the public sector governance environment is also changing. Citizens have higher expectations of government and the public service and demand more effective, efficient and economical levels of service. Public sector managers are responding to the demands of their particular operating environments by developing tailored approaches; streamlining and adapting traditional ways of providing services, particularly through technological advances; and by taking advantage of partnerships and similar alliances that blend the public and private sectors.

It is incumbent on Parliament and the ANAO to have a good understanding of the new public sector business environment, so that together we can contribute proactively to change. Ongoing guidance, or at least any perspectives from the Government and Parliament in any redefinition of the boundaries of the changing public sector environment are crucial. In this latter respect, the increasing involvement of the private sector in the delivery of public services is challenging traditional notions of accountability, an issue that is central to good governance.

While diverse governance approaches may now be required by the dynamic nature of the contemporary public service environment, one lesson remains constant: sound process will lead in most cases to good outcomes. Results count, but it is also important how these results are achieved. For the ANAO, a key issue is getting the balance right between control and innovation¹ in order to provide the guidance and the leadership demanded by a rapidly changing world virtually shrunk by modern communications and transport. In achieving this goal, the ANAO relies importantly on ongoing feedback

and guidance from the Parliament and other audit clients as to the areas they see as adding most value to public administration. This dependence is a recognition that these stakeholders are important in the distillation of wider public concerns.

One of my senior audit colleagues underlined the importance, for all those responsible for implementing sound corporate governance arrangements in a more complex environment, to understand the legal and quasi-legal construct of their obligations. He pointed to the often numerous pieces of legislation applying to public sector organisations, as well as a raft of policy and other guidelines that need to be taken into account. The Public Service Commissioner recently observed that:

The first principle, in my view, for good decision-making is compliance with the law.²

Nevertheless, corporate governance is not wholly a legal concept, for example where, for private and public corporations, aspects of internal corporate regulation are directed by the *Corporations Act 2001*. Many of the procedures and practices of a corporation are left to be determined and implemented by each corporation.³ In my view, auditors have valuable roles to play in providing assurance about compliance as well as about the effectiveness of actions taken to ensure robust governance arrangements.

This paper, which draws on a recently published Occasional Paper⁴ on the future direction of auditing, begins with a discussion of the role of the ANAO in supporting democracy. It then moves to an analysis of governance and auditing in the changing accountability environment. The paper concludes with a discussion of the importance of dynamic relationships with both the Parliament and the Australian Public Service (APS) for the ongoing relevance and credibility of the ANAO as the independent external auditor of Commonwealth organisations.

1. THE AUSTRALIAN NATIONAL AUDIT OFFICE

Role and responsibilities

In the context of the Commonwealth, the Office of an independent Auditor-General is an essential element of our system of democratic government. The Auditor-General provides vital assurance as to the transparency and accountability of public sector operations, as well as providing guidance and leadership in relation to some basic elements of good governance. This is particularly important for a public sector characterised by continuous change. Independent financial and performance audits give the public confidence in both the public service and our system of government. As the Secretary of the Department of Prime Minister and Cabinet noted in an address marking the centenary of the APS, an ethical and accountable approach to public sector leadership requires ‘*a strong system of checks and balances, including a powerful Australian National Audit Office*’⁵.

Legislation

The *Auditor-General Act 1997* (the Act) provides a strong legislative framework for the Office of the Auditor-General and the ANAO to provide support to Parliament. The Act establishes the Auditor-General as an '*independent officer of the Parliament*' – a title that symbolises the Auditor-General's independence and unique relationship with the Parliament. The Act also outlines the mandate and powers of the Auditor-General and the functions of the ANAO, as the external auditor of Commonwealth public sector entities.

The Auditor-General's mandate extends to all Commonwealth agencies, authorities, companies and subsidiaries with the exception of performance audits of Government Business Enterprises (GBEs). Performance audits of wholly owned GBEs may only be undertaken at the request of the responsible Minister, the Finance Minister or the Joint Committee of Public Accounts and Audit (JCPAA). The JCPAA recently undertook a review of the Act to reinforce the important notion of independence and to enhance the ANAO's capacity to perform efficiently and effectively⁶.

The Act is a robust piece of legislation founded on the important notion of audit independence. It has generally been recognised as better practice audit legislation. Consequently, while the ANAO is part of the changed contemporary auditing landscape currently challenging both public and private sector auditors, we are also set apart from it due to our statutory independence. This is one of our major strengths which enhances our reputation and effectiveness.

Contribution to public sector accountability

The office of the Auditor-General of the Commonwealth of Australia dates back to the beginning of Federation, being created by the Commonwealth Parliament in 1901. As discussed above, the Auditor-General has a broad mandate, currently enshrined in the *Auditor-General Act 1997*, to audit the financial statements of all Commonwealth entities, and subject to some qualifications, to undertake performance audits of those same entities.

The Auditor-General, through the ANAO, provides an independent review of the performance and accountability of Commonwealth public sector in its use of public resources. Through the delivery of an integrated range of high quality audit products that are timely, cost effective and consistent with public sector values, the ANAO aims to meet the needs and expectations of the Parliament, the Executive and audit clients and to add value to public sector performance and accountability. As with other public sector organisations, we expect to be judged both by our results and the manner in which we achieve those results.

The ANAO provides independent assurance on the financial statements and financial administration of Commonwealth public sector entities to the Parliament, the Executive, Boards, Chief Executive Officers (CEOs) and the public. We also aim to improve public sector administration and accountability by adding value through an effective

program of performance audits and related products including Better Practice Guides. As well, communication of our activities and their outcomes through representation at a range of Parliamentary Committees, agency audit committees and Boards of government authorities and companies, is a growing element of our value adding activities. We also seek opportunities to contribute to the development of the accountability framework, including better practice and standards (including harmonisation) in public sector accounting and auditing, through professional and other audit bodies in Australia and overseas.

Contribution to the Parliament

The Parliament is our primary client, using New Public Management (NPM) terminology. Our interaction with both individual parliamentarians and Committees gives us the opportunity to ensure that our financial and performance audit products and services are tailored to Parliament's needs. Our relationship with the Parliament is crucial to our ability to maintain the quality and reliability of our reports, and consequently for our performance. It is the Parliament that makes the ultimate decision on the ANAO's resources. This is important for signalling the independence of the Auditor-General by removing the issue of fee dependence between auditor and auditee in the Commonwealth Public Sector.⁷ Parliament is our number one client, which is a clearly different relationship to that experienced in the private sector. Nevertheless, all ANAO products are fully costed and transparent as an important part of our accountability to Parliament.

A key feature of the legislation supporting the ANAO's independence is the role of the JCPAA in approving the Prime Minister's recommendations of both the proposed Auditor-General and the ANAO's Independent Auditor; in advising on planned ANAO audit activity; and in recommending the budget for the ANAO to the Parliament and the Government each year. The JCPAA is also a conduit for the communication of Parliamentary leadership and guidance in relation to matters challenging public sector administration. While the ANAO seeks to build strong relationships with all members of Parliament through a variety of forums, including Parliamentary Committees, it is the JCPAA that has a special role in relation to the ongoing activities of the Auditor-General.

The special relationship between the JCPAA and the ANAO is also what sets us apart, in several important areas, from other independent agencies charged with the regulation, or review, of public sector activities. As noted earlier, the ANAO has a powerful position within the democratic framework, which is reinforced by robust legislation. It is not dependent on any individual Minister for authority, which means that the Auditor-General has the ultimate responsibility for setting the scope of his or her activities. Finally, by contrast with the CEOs of other independent government agencies, the Auditor-General is appointed with the direct involvement of the JCPAA, rather than solely by the Executive and/or a particular Minister. This also ensures that the position is seen as not being subject to political influence, given its direct line of responsibility to the Parliament, rather than to a particular Minister or the Government.

One important element supporting the Auditor-General's ability to report without fear or favour, is the application of Parliamentary privilege to performance and financial statement audit reports tabled in the Parliament. This privilege can operate to protect the Auditor-General and ANAO staff from being held liable for statements contained in audit reports. This in turn allows the Auditor-General to report freely, openly and responsibly on matters examined in the course of audits. Recently, however, there has been some concern as to whether draft reports and working papers leading to official public reports are similarly covered by Parliamentary privilege. The JCPAA examined this issue in the course of its recent review of the Act. The Committee recognised that:

*The provision of Parliamentary privilege is an essential element in protecting the office of the Auditor-General so that it may provide a fearless account of the activities of executive government.*⁸

Legal advice provided to the ANAO suggests that, until a court decides to the contrary, it is proper for the Auditor-General to proceed on the basis that Parliamentary privilege does apply to draft reports and working papers. The JCPAA accepted this approach. However, the Committee considered that the Privileges Committees of both the Senate and the House of Representatives should examine this complex issue to provide greater clarity.

The ANAO notes that this is a particularly important issue given the increasing involvement of the private sector in public administration. We are sensitive to concerns of commercial confidentiality, which could lead to reputation and market problems if not handled well in public reports, as well as possible legal action. However, such concerns need to be looked at in a broader context, as I will discuss later.

The problem extends beyond the Commonwealth to the States and Territories. For example, on this point, it should be noted that a recent ACT Supreme Court ruling may have significant implications for legal liability arising from working papers or draft reports prepared in the process of producing public documents. The ACT Supreme Court found, in its review of the board of inquiry into disability services (the Gallop inquiry), that Parliamentary privilege does not retrospectively protect the preparation of a document by or for the Government (even if the document is subsequently tabled in Parliament) if the report has been tabled for a purpose other than that for which it was originally intended.⁹

The JCPAA has the power to report to Parliament on the use of public moneys by Commonwealth entities with respect to any matters concerning their accountability, lawfulness, efficiency and effectiveness. The JCPAA examines ANAO reports on a quarterly basis to assess the significance of matters raised and the adequacy of responses from audited agencies. This is an important level of scrutiny both of the audited agencies and of the ANAO's activities and findings. The JCPAA may conduct public hearings on matters raised in ANAO reports at which agencies are required to attend and give evidence. The Committee's findings and recommendations are set out in reports that are tabled in both Houses of Parliament. This enhances the level of assurance provided to the Australian public and can lead to important administrative or even, in some cases, policy change.

My colleague, the Controller and Auditor-General of New Zealand, recently observed that Parliament and the general public will be confident the Audit Office has done a good job when public entities:

- *are delivering what they have been asked to;*
- *have operated lawfully and honestly, and have not been wasteful;*
- *have fairly reported their performance; and*
- *know that, if this is not the case, we will tell them.*¹⁰

As well, government and public entities:

- *will effect improvements in public sector performance and accountability in areas where we have advised that there is potential for improvement.*¹¹

2. ACCOUNTABILITY IN THE 21ST CENTURY

The major trend influencing public sector accountability in the twenty-first century, is the convergence of the public and private sectors in Australia and overseas. Convergence has occurred in response to demands for more effective service delivery and as a direct consequence of the introduction of contemporary public sector reforms under the NPM banner. The most significant of these reforms, in terms of their far-reaching effects on governance arrangements, has been the trend toward the outsourcing of functions and the greater focus on the contestability of services in the public sector.

The reforms were largely based on the premise that greater efficiency and lower costs could be achieved by applying private sector practices to public sector service delivery. In some cases, this means that private sector management models have overlaid traditional public sector activity. In others, the private sector has become fully incorporated in the delivery of public services through contract, through varying degrees of cooperative and/or partnership arrangements.

The changed business environment has created new challenges for the ANAO just as it has for the agencies we audit. New operating conditions and increased complexities have reinforced the importance of strong and dynamic relationships with all of our clients, but most particularly with the Parliament itself.

Governance in a changing public sector environment

Convergence, and other external trends, including the impact of new technologies, have added a new level of complexity to traditional accountability frameworks. This has reinforced the importance of implementing robust and responsive corporate governance approaches. Citizens are increasingly directly involved in the public sector decision-

making process. They are demanding improved levels of access and standards of service from Commonwealth agencies.

While the achievement of value for money outcomes is well established as a public sector priority, the opportunities offered by new service delivery arrangements, and more flexible funding initiatives, including the use of private financing, produce additional challenges for accountability and, consequently, for governance. What we have seen in recent years has been the emergence of tailored approaches defined, and largely determined, by individual agency CEOs. This was what would have been expected from the devolution of authority from the central agencies as a key element of public sector reform. While this may be an appropriate response to the changing business environment, the ANAO is committed to ensuring that, whatever their strategies or approaches, agencies are giving effect to Parliament's intentions while managing their identified risks in a proactive and responsible manner. Again, this should be expected with governments and Parliaments providing legislative authority for efficiency/performance audits.

Expectations of citizens

New client service interfaces, and improved access to information and communication technologies, have raised citizens' expectations of more responsive public sector service delivery. Technological developments increase citizens' demands for the same type and level of service from government as they receive from the private sector, that is, virtually on demand. Governments worldwide are focussing on harnessing the opportunities created by new technologies, while managing the risks inherent in this new form of service delivery. Government use of new technologies is discussed later in this section of the paper.

Those more actively engaged citizens are also participating more fully than ever before as partners in public sector decision-making and service delivery. The challenge for the public sector is to tailor traditional notions of governance to make room for diverse stakeholders while still ensuring robust accountability to Parliament. This is not always straightforward, as it becomes increasingly difficult to separate the concept of 'the public interest' from the interests of community participants actively engaged in service delivery.

Another key expectation of Australian citizens is obtaining greater value for money from government services. Those judging the performance of the public sector need to understand the wide-ranging scope of that concept. Value for money involves more than simply realising the lowest possible price. Rather, it involves maximising overall value for the taxpayer and ensuring proper accountability for the use of public resources. This includes consideration of less tangible elements such as client satisfaction, the public interest, honesty, justice, privacy and equity. In meeting the challenge of obtaining value for money in a climate of sectoral convergence, it is imperative that public sector agencies entering into partnerships with the private sector have a full appreciation of risks to the public resources with which they have been entrusted. Such risks include taking advantage of opportunities as well as avoiding, for

example, degradation, inefficiency and loss of resources and of performance. As one commentator posits:

*there is ... no room for complacency as the public sector environment has changed from an administrative culture to a management culture in which governments and citizens expect better value from the same and continually reducing financial resources.*¹²

Convergence of the public and private sectors

The convergence of the public and private sectors has occurred largely as a consequence of demands for more responsive service delivery and for improved efficiency in both sectors, for example, as part of the National Competition Policy, impacting on all levels of government and private sector firms. It provides the opportunity for public sector agencies to gain from specialist expertise and international better practice in complex and dynamic areas such as information technology and communications. However, convergence also brings into sharp focus the differences between the two sectors, which need to be managed responsively on a case-by-case basis. Together, the Parliament and the ANAO have a very important role to play in terms of defining and strengthening acceptable accountability frameworks for the twenty-first century.

Public and private sector agencies have very different legal and accountability requirements. For the public sector, legal responsibilities are defined by specific functional statutes as well as general requirements outlined in legislation such as the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*. By contrast, private sector organisations have specific obligations under corporations law¹³ and trade practices legislation, as well as relevant State/Territory legislation. The legislature has further contributed to strengthening private sector accountability. For example, the amendments to the *Privacy Act 1988*, which came into effect on 21 December 2001, have exposed the private sector to similar privacy obligations to those that already existed in the public sector. Commonwealth agencies have their primary accountability to the Executive and the Parliament. Private sector companies, however, have as their primary responsibility the provision of shareholder value.

While there are obvious potential tensions when the two sectors work together, there are also opportunities for both parties to benefit. As the Commonwealth's independent audit office, our goal is to use our knowledge and experience of the impact of convergence across the public sector to assist our clients in achieving their aim of doing their business better within the public sector accountability framework, however that is developed and applied. To be able to achieve this goal, we must continue to work in strong cooperation with the Parliament to ensure that the wide-ranging goals of the Parliament, and, beyond it, of the Australian people, are being effectively achieved.

I noted a particular emerging problem in my Annual Report for 1999-2000 with the increasing coverage of the private sector in performance audit reports. I recognised the possible consequences for a firm's reputation and its market situation flowing from any

adverse audit comments, or references, on actions or lack of action and/or management/administration practices. The situation seems to be accentuated where there is overseas ownership. In particular, the legal issue of defamation has been raised which can result in the use of language that may be counter to simple, clear, and straight-forward explanations.

The provision of a draft performance audit report for comment under Section 19 of the *Auditor-General Act 1997* is not a 'negotiating process'. It is a means of ensuring that the ANAO has an accurate understanding of the 'facts' and those facts are correct. This is necessary for the credibility and acceptability of audit findings and recommendations. Conflicts of public and private interest are not new but their resolution in performance audits is a challenge for all parties without a genuine shared understanding of what constitutes public accountability.¹⁴

In response to concerns expressed about accountability to the Senate in a recent Senate Finance and Public Administration References Committee Report, the Government indicated that it is supportive of making suppliers to government aware that contracts and contract related material may be requested by, and provided to, Parliament and its Committees, recognising, where appropriate, the application of public interest immunity.¹⁵ The response also noted that the Commonwealth Procurement Guidelines and Best Practice Guidance (February 2002) require that:

*Agencies should include provisions in tender documentation and contracts that alert prospective providers to the public accountability requirements of the Commonwealth, including disclosure to Parliament and its Committees.*¹⁶

Challenges to transparency

The main element of public sector accountability is openness or transparency. With the greater involvement of the private sector, concerns have been expressed about commercial considerations, particularly in maintaining competitive advantage. Most would accept that the tendency in the private sector has been not to go public unless it is clearly in the organisation's interests. The requirements, if not the fact, in the public sector should be the reverse, except in special circumstances such as national interest considerations.

The ANAO has found that value for money results from public-private sector partnerships can be particularly difficult to demonstrate where commercial-in-confidence provisions of contracts apply. With the increased convergence of the public and private sectors, demonstrating transparency, accountability and the ethical use of resources has the potential to become clouded unless the Commonwealth takes a proactive and consistent stance to the scrutiny of contracts involving public funds. As one commentator noted:

*while [Commercial-in-Confidence] may be good for business, it is inimical to the fragile processes of participatory democracy.*¹⁷

In general, the roles and responsibilities of both public and private sector partners in relation to Commercial-in-Confidence issues require clarification. All parties involved in service delivery must clearly understand their accountability requirements and their ultimate responsibility to the Parliament. The ANAO has undertaken a number of audits in this area to date in response to Parliament's concerns. One report, entitled *The use of confidentiality provisions in Commonwealth contracts*¹⁸, found that there was a lack of consolidated government-wide guidance available to agencies on the use of confidentiality provisions in contracts. The audit found a number of weaknesses in the ways in which agencies generally deal with the confidentiality provisions in contracts. There was a lack of clarity in terms of the specific information that should be regarded as commercial-in-confidence in contracts, and agencies were addressing commercial-in-confidence issues in a less than rigorous, or risk-managed, way. This was threatening accountability and frustrating Parliamentary Committees and other forums of review¹⁹. The ANAO made a number of recommendations in the report aimed at enhancing the management of commercial-in-confidence issues in contracts.

The commercial-in-confidence issue was revisited by the ANAO in the recent audit of the implementation of a Senate Order of 20 June 2001²⁰ that required all agencies covered by the *Financial Management and Accountability Act 1997* to list contracts over \$100 000 in value on the internet. The Order requires that agencies indicate, amongst other things, whether contracts contain provisions requiring the parties to maintain confidentiality of any of their provisions or whether the parties regard any provisions of the contracts as confidential. The ANAO found that, overall, there was a positive response to the Senate Order. There were also positive indications that a number of agencies were developing, progressively, more detailed guidance to assist staff in determining aspects of contracts that might need to be protected as confidential. This is a step in the right direction, although agencies still have some way to go in applying guidance in a manner expected by Parliament. Nevertheless, the onus is now clearly on those wishing to maintain confidentiality to justify that position. Put another way, it has been suggested that business, commercial or financial information should generally be available in the public domain:

*unless it can be demonstrated that to disclose it would be to prejudice the competitive position of the private contractor in question.*²²

Resolution of this issue is just one of the problems facing agencies negotiating the converging governance landscape. Commercial-in-confidence issues have challenged both agencies, and their auditors, in terms of our ability to provide assurance as to the efficient and effective administration of public resources. The JCPAA has recently moved to provide greater clarity in this area with a recommendation that:

*all CEOs under the Financial Management and Accountability Act 1997 should, whenever claiming commercial-in-confidence, issue a certificate stating which parts of a contract and why these parts are to be withheld.*²³

In its response to this recommendation, the Government noted that it:

*does not support the view that commercial information is inherently confidential. Any decision to withhold information on [commercial-in-confidence] grounds needs to be fully substantiated, fundamentally stating the reasons why such information should not be disclosed.*²⁴

A related issue is that of Cabinet confidentiality and collective responsibility for administrative decisions. In a recent audit of the Federation Fund program²⁵, the ANAO found that reasons for Ministers selecting, or not selecting, particular Federation Fund projects were generally not available. Successive governments have supported the conventions of Cabinet confidentiality and collective responsibility by the practice of not disclosing the deliberations of, or reasons for, decisions by Cabinet and its committees.

The lack of documentation surrounding the Ministerial appraisal process and the lack of information on reasons for decisions highlights a tension between the standards expected for public administration and the normal Cabinet conventions. In the case of the Federation Fund, this precluded the ANAO from forming an opinion as to whether the proposals selected by the Government were likely to represent best value for money in terms of the program objectives. This is a tension for Government and the Parliament to resolve. As public sector auditors, we will be guided by the accountability standards that Parliament indicates are appropriate. However, in a changing governance environment, accountability issues are constantly emerging, and, where addressed by public sector managers, are likely to be considered either in the 'traditional' accountability framework or in a more private sector influenced environment.

New service delivery arrangements

As well as contemplating the benefits of public and private sector convergence, many agencies in Australia, like their counterparts overseas, are currently reconfiguring the way that they do business to take advantage of opportunities for networked or 'joined up' service delivery with other public and private sector agencies. Canada has experimented with networked partnership arrangements to good effect. The United Kingdom has indicated that 'joined-up government' is central to its modernising government initiative.

While there are potential benefits in this type of approach, there is also a need to clarify the governance arrangements that are intended to support the demonstration of accountability. Traditional public sector accountability arrangements do not fit these diverse forms of partnerships. Consequently, there is a need for tailored, innovative approaches based on a full appreciation of the risks and benefits involved, if there is to be credible accountability to Parliament for both the results and the manner in which they are achieved.

This is particularly the case where the public sector makes use of private sector financing to deliver public services. Private financing initiatives (PFI) have been used in areas such as infrastructure, property, defence and information technology, and have

been explored in a number of countries in response to fiscal pressures. Private financing gives rise to additional challenges and demands for public accountability and transparency because of the substantial shifts in risk. The potential liabilities accruing to governments may be substantial.

The evaluation of the costs and benefits of private financing are not straightforward. This is because the government can usually borrow funds at a lower rate than most private organisations. The real potential benefit from private financing lies in the cost savings of the total package and/or the transfer of risk. Nevertheless, there is the concern that the ultimate risk always rests with the public sector to the extent that the public sector has over-arching and enduring accountability responsibilities, regardless of the commercial relationships it enters into, to achieve its objectives. This is particularly evident in the Defence area and raises issues about the nature of lease arrangements and their accounting treatment.

In Australia, the States and Territories rather than the Commonwealth have undertaken most private financing to date, although the recent priority given to public/private partnerships in the context of the AusLink land transport plan may considerably increase the use of PFI at the Commonwealth level. Victoria and NSW have already used private financing arrangements for road and associated infrastructure projects. State Audit Offices have noted difficulties in establishing clear financial benefits from the private financing approach and, in one case in NSW, Parliament was denied access to the contract deed between the public sector roads authority and its private sector partner.²⁶ This further highlights the tensions inherent in the convergence of the public and private sectors that I raised earlier in relation to commercial-in-confidence issues.

For agencies, private financing poses significant challenges in terms of accountability. Agencies need to demonstrate the net benefits from adopting private financing as well as the satisfactory management of risks. The net benefits may well involve intangible benefits that are not easily verified. In addition, risks need to be managed in a transparent way that enables full disclosure of the probity arrangements in place. Of particular interest is any cost/benefit evaluation, the basis used for risk allocation and access to information in the possession of the private sector. These elements of decision-making can be quite complex and are not without resource implications. As a result, we will be conducting audit reviews in the future on PFI arrangements.

Tailored approaches

Greater flexibility in management, and corresponding increases in personal accountability, have become central features of the current administrative arrangements. For example, personal responsibility has been delegated to the heads of agencies, now known as CEOs. This approach reflects the private sector management model. It also creates new opportunities and risks that require effective and appropriate corporate governance frameworks if the public interest is to be protected without stifling the benefits offered by the new flexibilities. A real challenge for such frameworks is to strike an appropriate balance between conformance and performance. I spoke earlier of the need to understand the legal construct and the compliance imperatives, for example

in personal liability concerns by governing boards. However, there is also a need to both address such concerns and achieve required outcomes or results.

While the devolution of responsibility for agency accountability to agency heads may create the conditions for more responsive tailored management approaches, it also brings some significant risks in terms of overall public sector governance. Currently, it could be argued that we are determining accountability requirements by default as agencies are engaged in setting their own boundaries, which may or may not be acceptable to Parliament, in the absence of across the board guidance on these issues. The ANAO's position, as the public sector auditor, gives it some scope to assist in this area. However, there is also a strong need for widespread debate on this issue and for guidance from the Government and the Parliament. Such guidance would be more helpful if it went beyond a general requirement for agencies to remain ultimately accountable, or that they cannot outsource accountability.

Values and ethics are a very important part of Commonwealth administration. The *Financial Management and Accountability Act 1997* requires CEOs to promote the efficient, effective and ethical use of Commonwealth resources for which they are responsible. The *Public Service Act 1999* sets out values, and the APS Code of Conduct for Commonwealth employees. However, in contractual arrangements, it is often very difficult to enforce conditions relating to values and ethics on private service providers. Interestingly, some Commonwealth contracts are now including clauses that seek to apply the relevant sections of the *Public Service Act* to private sector employees. It is difficult to envision how the disciplines could be applied in practice. However, if it is an indication of intent, and goodwill, the legal imperative may not prove to be particularly relevant.

One approach is to endeavour to create partnerships with bodies that have a shared culture, including values and ethics. At a minimum, there needs to be a shared understanding of what is acceptable behaviour in a public sector context, as well as appropriate corporate governance arrangements in place to at least manage adherence where this is critical to the success of the initiative or material to the risks involved. Parliament can play an important role in this area by indicating what it regards as acceptable, or unacceptable, public sector behaviour. The ANAO will continue, as part of our Audit Strategy, to conduct performance audits that examine the appropriateness of corporate governance arrangements in individual agencies. Such audits take into account those factors that bear directly on appropriate accountability and outcomes being achieved. In many cases, the former are integral to the latter.

The Government has committed to pursuing the benefits of partnership approaches both between, and among, the public and private sectors. A range of approaches from the application of elements of private sector management models, to partnerships, and right through to fully outsourced arrangements has reconfigured the contemporary governance landscape. Advances in technology have served only to accelerate the impacts of these changes. The key challenge for agencies is to ensure that, in taking advantage of the various opportunities of the new environment, they do not lose sight of their ultimate accountability to the Parliament, and beyond the Parliament to the Australian public.

Government use of new technologies

As well as heightening citizen expectations of access and service (as mentioned earlier), advances in technology have offered new opportunities to harness the benefits of convergence and alliance-making both between, and among, public and private organisations. For example, the UK's 'joined up government' strategy recognises that planning for improved electronic service delivery offers the opportunity to break down departmental boundaries and alter the 'silo-based' delivery modes traditionally associated with government agencies acting independently. A fundamental principle of the UK strategy is that citizens interacting with government should be able to do so whenever they choose. They should not need to understand the way in which government is structured to secure the services they need. The aim is that the complexity of dealing with government disappears, while at the same time the UK's 'Government Gateway' provides security and benefits for government.²⁷ In Australia, the e-government strategy – 'Government Online' – has similar aims.

Rapid advances in technology offer both opportunities and challenges in the converging business environment. In my experience, a major risk inherent in the shift to electronic delivery and decision-making is that of security. In addition, there are accountability issues for agencies, and consequent evidentiary issues for their auditors, when traditional forms of record-keeping are overtaken by the outputs of new technology. For example, we need to make links in the chain of decision-making in agencies which have largely, or totally, shifted out of paper records. One consequence is that audit trails have to be embedded in electronic records and/or archival data tapes. This is important in terms of agencies' capacity to demonstrate accountability to the Parliament.

The delivery of services via the internet also introduces new risks and exposures that can result in a legal liability for government. Well-designed security and privacy policies can minimise such risks and liabilities, while informing agencies' clients of important aspects of the standard of service they can expect to receive. The benefits associated with a radical re-thinking of the structures and manner in which government services are delivered to citizens could be considerable. In this respect, there has been concern expressed about equity of access to government services through technology for those who do not have such ready access. Continuation of more traditional service delivery methods as an option to ensure equity, imposes costs which need to be balanced against the overall objectives to be served. The message I am endeavouring to convey is that there are commensurate risks that have to be managed well within a robust control environment that is central to sound corporate governance.

Record-keeping

Transacting business in the electronic environment, whether acting as an individual agency, in partnership with the private sector, or other government agencies, also raises the issue of record-keeping, and particularly the provision and maintenance of electronic records. The use of e-mail in decision-making is often not supported by record-keeping

protocols able to withstand independent scrutiny. My Office has been incorporating reviews of electronic records in its auditing methodology for some time now. For example, in the absence of an adequate suite of supporting hard copy documents, the ANAO reconstructed and analysed the electronic e-mail record to establish the decision-making trail in its investigation of the probity and effectiveness of the decision to include Magnetic Resonance Imaging (MRI) machines²⁸ that were 'on order' in the 1998 budget.

In the public sector at the moment, we have a three tiered hierarchy of records as follows:

- hardcopy documentation (traditional paper file based records);
- electronic or digitally based information (including diaries and e-mail archives); and
- oral communications which may or may not be supported by notes.

While the format in which information is gathered may change, the accountability obligations on public service officers do not. The ANAO has recently undertaken an Assurance and Control Assessment (ACA)²⁹ audit of record-keeping³⁰. The audit assesses record-keeping policies, systems, and processes in terms of good business practice, requirements under the *Archives Act*, relevant Government policies, and professional record-keeping principles. As well, it identifies some better practices and strategies organisations can adopt to manage the transition to an e-government environment. The audit findings will guide future developments by National Archives.

A critical factor identified was to view record-keeping strategically as part of information management more broadly, and to view records as a corporate asset. Record-keeping helps in servicing clients and in dealing positively with legal and other risks. Tied in with broader information management, record-keeping assists overall business performance. Unfortunately, history shows that, in a pressured environment, record-keeping lapses, despite its importance for both internal and external stakeholders. This is a challenge for the governance framework.

As well, records are an indispensable element of transparency, and thus of accountability, both within an organisation and externally. Records are consulted as proof of activity by senior managers, auditors, members of the public or by anyone inquiring into a decision, a process or the performance of an organisation or an individual. It is worth noting that, since 1996, the National Library of Australia (NLA) has been storing electronic publications that it considers have national significance (in parallel with its hard copy collection.) The NLA includes ANAO audit reports in its electronic archive to ensure that Australian citizens will have access to this aspect of their documentary heritage now and in the future.

As we move towards the era of e-government, ensuring the creation and maintenance of appropriate electronic records will be equally as important as ensuring appropriate security and privacy in electronic transactions between governments, citizens and the

business community. This is necessary for the confidence of all stakeholders, and particularly for the Parliament.

Auditing in a changing public sector environment

The Auditor-General, in partnership with the Parliament, has an important role to play in the new accountability environment in terms of providing assurance and advising on change and its impacts across the public sector. In this regard, the ability of the Auditor-General to investigate and report, freely and fearlessly, is crucial. The essential challenge is for managers to balance efficiency and effectiveness imperatives with the need for accountability to all stakeholders. Accountability mechanisms should be tailored to the individual risks identified for each particular program or outcome. In navigating the new business environment, agencies require clear guidance in relation to appropriate standards of accountability. In this regard, guidance from both the Government and the Parliament is vital.

Audit independence

Corresponding with public sector changes, the role of the Auditor-General and the place of auditing in democratic government have also changed. While the accountability imperative remains constant, the role of the ANAO has evolved to take account of, and respond positively to, the public sector reform agenda. In today's environment, our role includes providing independent assurance on the performance, as well as the accountability, of the public sector in delivering the government's programs and services and implementing effectively a wide range of public sector reforms. I cannot overstate the importance of the independence of the Auditor-General in this respect. As the public and private sectors converge; as the business environment becomes inherently riskier; and as concerns for public accountability heighten; it is vital that Auditors-General have all the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them by Parliament.

The debate over audit independence is not new, although it has attained an increased popular profile in the wake of the collapse of Enron in the United States. Audit bodies and the accounting profession worldwide have been actively engaged in clarifying and reinforcing independence for many years. However, recent events have put the debate on to a different plane with higher level expectations being generated. While the ANAO takes a professional interest in this ongoing debate, it is also set apart from it by virtue of its statutory and functional independence. Nevertheless, there is also an operational imperative with the ANAO outsourcing a not insignificant proportion of its audit work to private sector accounting firms. As well, with the increasing use of such firms by the public sector for internal audit, we are often dependent on their work in coming to an audit opinion on organisations' control environments and financial statements.

As discussed earlier in this paper, the independence of the Commonwealth Auditor-General is a key feature of our democratic system of government. Three elements are crucial to reinforcing the independence of the Office: the powerful *Auditor-General Act 1997*; direct financial appropriation as part of the Budget process; and the ability of the

Auditor-General to develop and set professional standards for his/her Office. Recently, Senator Murray outlined what he considered to be the four fundamental pre-conditions for more generic auditor independence as follows:

- the appointment process must be objective, on merit, and not influenced by improper considerations;
- security of tenure has to be guaranteed for a known and viable period;
- ending the appointment must be subject to known and proper criteria, not capricious or improper considerations; and
- remuneration has to be sufficient to ensure that the task can be properly fulfilled, sufficient to prevent improper inducements being attractive, and sufficient to cover reasonable risk arising from the task.³¹

While the debate will continue amongst the profession worldwide, the issue of audit independence will come under further scrutiny in Australia with the JCPAA's recent decision to launch an inquiry into this topic. The JCPAA will examine whether government should intervene to regulate the auditing profession. The issue of auditor independence is also likely to be considered as part of the royal commission into the collapse of HIH. The Statement of Auditing Standards AUS 1 requires an auditor not only to be independent, but also to appear to be independent. For the purpose of this Statement:

(a) actual independence is the achievement of actual freedom from bias, personal interest, prior commitment to an interest, or susceptibility to undue influence or pressure; and

(b) perceived independence is the belief of financial report users that actual independence has been achieved.³²

While the Statement of Auditing Practice provides guidance to auditors when considering independence, the recently released Professional Statement F1, entitled 'Professional Independence' addresses the principles of independence. The ANAO supports the Ramsay Report³³ recommendation that the auditor should make an annual declaration, addressed to the board of directors, that the auditor has maintained his/her independence in accordance with the *Corporations Act 2001* and the rules of the professional accounting bodies. I should note that, pursuant to that Act, the Auditor-General is a registered company auditor.

As a result of the Enron collapse in the United States, we have already seen the separation of audit and consulting activities in major accounting firms. Private firms in Australia are responding to these challenges in a number of ways, with PricewaterhouseCoopers recently establishing an independent board to oversee the firm's audit standards, whereas Ernst & Young has stated the preference for 'embedding strict quality control procedures in the culture of the firm rather than necessarily having an oversight board',³⁴.

Another concern has been the rotation of auditors within specified time periods. Recently, there has been a suggestion by the Australian Securities and Investments Commission (ASIC) that companies be required to rotate audit firms rather than engagement partners³⁵. This is an issue of some contention, for example, in relation to practicality, effectiveness and higher cost. It has been suggested that higher costs be amortised over five years, equal to a seven per cent increase in audit fees each year.³⁶ The ANAO has covered this, and a number of other relevant issues, in its submission to the JCPAA inquiry.

The issues relating to independence are difficult and are still to be resolved. The need for active ongoing discussion is clear. As the United States Panel on Audit Effectiveness noted in its review of the current audit model:

*Independence is fundamental to the reliability of auditors' reports. Those reports would not be credible, and investors and creditors would have little confidence in them, if audits were not independent in both fact and appearance. To be credible, an auditor's opinion must be based on an objective and disinterested assessment of whether the financial statements are presented fairly in conformity with generally accepted accounting principles.*³⁷

There is growing pressure for the exclusion of audit firms from other activities within the same organisations. For some years, there has been general acceptance of the desirability of those firms not being engaged both as internal and external auditor. In my view, the questions about possible conflicts of interest, audit rotation and selection of auditors are central to the roles and responsibilities of audit committees as part of the corporate governance framework. One challenge is therefore how to strengthen those roles to enhance their effectiveness and credibility in the eyes of both internal and external stakeholders. However, I note that an ASIC survey of auditor independence found that 'it was not normal for the level of non-audit services to be given consideration by the board or the audit committee'³⁸. In fact, usually the Chief Financial Officer was the primary person responsible for engaging the external auditor in these roles. Reverting back to the auditor rotation issue, the survey also indicated that 'the vast majority of respondents did not have a policy of rotating audit firms'³⁹.

The recent series of high profile Australian corporate collapses including HIH, One.Tel and Ansett have renewed attention to the issue of the roles and responsibilities of both private and public sector auditors in the Australian context. Citizens are more aware of governance issues than ever before. Of particular recent interest has been the focus on personal accountability of directors and senior executives whose performance bonuses may be inversely proportional to trends in share prices and company profits. The public expects that auditors will alert shareholders or other stakeholders to the fundamental soundness (or otherwise) of business entities. It should also be noted, however, that the mere fact that auditors are independent will not save companies from collapse or agencies from the impacts of poor management. As noted in a recent legal update on corporate governance:

*It is clear that the most rigorous and independent audit will not save a company with poor management and business practices from insolvency.*⁴⁰

This view was endorsed recently by the Chairman of the Australian Securities and Investments Commission who noted that, when it comes to a company's compliance and accounting standard, '*the final buck stops with the board*' rather than with company auditors.⁴¹ Auditors do, however, have a very important role to play in terms of providing advice that draws on their broad range of experiences which may range across the public and private sectors. Any concern and/or suggestions should be conveyed in the audit management letter and/or discussed directly with the board of directors, who actually appoint the auditors in the private sector. One issue is whether, how, and to what extent, should the contents of such a letter be conveyed to other stakeholders. As an aside, I note Senator Murray, in the article previously referred to, observed that audit independence requires appointment by a third party, for example an elected corporate governance board additional to the main board.⁴²

However, I cannot overstate the fact that the ANAO operates in an advisory capacity, rather than participating directly in decision-making by public sector managers. While I urge my officers to 'stand in the managers' shoes' in order to understand the complexities of the particular business environments under review, it is for the managers themselves to decide whether or not they will act on ANAO or other advice with reference to their particular risks and opportunities. This is one essential difference between management consultancies and the public sector audit approach. Our 'observer status' as public sector auditors reduces the risk of conflict of interest issues arising in the course of our work. Nevertheless, that does not absolve us from any responsibility to the Parliament for our views and actions.

The ANAO considers that there is a range of steps that could be taken to strengthen the independence of auditors and provide greater public confidence in their performance and the role that they have in adding credibility to financial reports prepared by companies, including:

- underlining the independence of auditors in statute;
- enhancing the role of audit committees in corporate governance;
- improving the disclosure of 'other services' provided by auditors;
- encouraging the profession to tighten current guidelines on 'other services' work that auditors are able to undertake;
- encouraging the rotation of auditors after a suitable time period, for example, seven years; and
- encouraging the wider involvement within the profession of users and preparers of financial statements and reports, particularly in the setting of auditing standards and guidelines.

These options for enhancing the independence of auditors may be pursued under the current co-regulatory model or through other forms of statutory, or non-statutory regulation. These are matters for decision by the government and the profession co-operatively, given the level of interdependence between both parties in current arrangements. Of interest, in this respect, is a recent report of the New York Stock Exchange Corporate Accountability and Listing Standards Committee which recommends that the U.S. Securities and Exchange Commission ‘should prohibit relationships between independent auditors and audit clients that may impair the effectiveness of audits’.⁴³

Audit mandate

One particular challenge in the changing public sector environment is the increasing tension regarding the mandate of the Commonwealth Auditor-General and the boundaries between government policy and its implementation. The Auditor-General’s performance audit mandate stops short of review of Government policy decisions. The scope of a performance audit may, however, incorporate the audit of information leading to policy decisions, an assessment of whether policy objectives have been met, and an assessment of the results of policy implementation both within the administering agency and, externally, on other involved bodies. The issue was given some prominence at the Federal level following two performance audits my Office undertook on property sales and IT outsourcing.⁴⁴

The audits attracted a significant amount of comment. Some of this comment focussed on the difficulties of negotiating the grey area between investigating government performance and commenting on public policy matters. Problems can arise where policy is difficult to separate from implementation, as was the case in both of the audits mentioned above. Professor Richard Mulgan, an academic at the Australian National University, sums up the nub of the issue:

*Performance audit assumes a clear distinction between policy objectives (set by elected governments) and policy implementation (carried out by servants or contractors). Auditors are assumed to leave the objectives to government and confine themselves to the efficiency, effectiveness and probity with which these objectives have been implemented. However, because the lines between policy and implementation, or between ends and means, are blurred and contested, the extent of the Auditor-General’s jurisdiction is similarly open to question.*⁴⁵

One ‘positive’ to come out of this debate is the recognition that government policy objectives need to be stated in less ambiguous terms, to assist in making perceived distinctions between policy and implementation reasonably clear.

From time to time, a number of performance audit reports raise issues including value judgements concerning the probity of the actions of the Government or Ministers, for example, the audits of Ministerial travel claims⁴⁶, GST advertising⁴⁷, and the Federation

Fund⁴⁸. These are not matters that the Auditor-General has the mandate to resolve, rather, this is a matter for the Parliament. It is not the role of the Auditor-General to directly hold the Government to account. This is the role of the Parliament and, ultimately, of the people. In that respect, Parliament has the benefit of audit reports to hold the Executive accountable. The media can also make a significant contribution to both public knowledge and understanding of relevant issues.

The performance audit mandate is an essential element of the accountability process in all public jurisdictions. However, performance auditing is not a static process. There will be a continued emphasis on improving our service to Parliament as our role is reconfigured and redefined in the changing governance environment.

Setting standards for accountability

Under the *Auditor-General Act 1997*, I am required to set auditing standards with which individuals performing Auditor-General functions must comply. This gives the ANAO the flexibility to set its own agenda and to develop appropriate auditing tools for the contemporary environment. In setting the standards, I acknowledge the commonality of professional requirements between private and public sector auditors and, as such, the ANAO auditing standards are formulated with regard to the auditing standards issued by the Auditing and Assurance Standards Board of the Australian Accounting Research Foundation (AARF). Consistency with international standards, including the International Organization of Supreme Audit Institutions (INTOSAI) Auditing Standards, and those of the International Auditing and Assurance Standards Board of the International Federation of Accountants is also a consideration. My deputy is currently a member of both the national and international auditing standards boards.

The current ANAO Auditing Standards incorporate the codified Auditing Standards and Auditing Guidance Statements issued by the AARF. In this context, and our broader role in the accounting environment, it is important for the ANAO to contribute to the process of setting these standards. Such involvement also gives us the opportunity to reflect distinctive public sector issues in the standard setting process. The same applies to accounting standards but with international harmonisation largely focussed on the private sector. However, I note that, in the Australian Accounting Standards Board (AASB) Policy Statement (PS4) on International Convergence and Harmonisation Policy, the AASB will take account of the interests of both the public and private sectors in Australia.

The importance of bringing together public and private sector accountants has also been recognised by the profession with the Institute of Chartered Accountants in Australia (ICAA) holding its first Government Accounting Forum earlier this year. This will become an annual event that brings together government finance representatives to share experiences and to debate government finance policy⁴⁹.

However, there is more to accountability than technical compliance. In this regard, the ANAO is guided by the Parliament in terms of appropriate accountability standards for the broader APS. As the preceding discussion has demonstrated, agencies are faced with diverse challenges for which tailored approaches are required. The 'privatisation'

of the public sector neither limits nor obviates the need for accountability to stakeholders. Rather, new players in the accountability chain, less direct relationships between stakeholders and service providers, and greater flexibility in decision-making, strengthen the need for accountability regardless of the manner in which it is determined. While the Parliament sets the acceptable boundaries for agencies in the new business environment, the ANAO is charged with ensuring that agencies get the balance right between efficiency and accountability within the boundaries specified by Parliament.

Systems for managing fraud and conflict of interest, in particular, are very important regardless of whether a service is delivered through the public or private sector. Conflict of interest is particularly topical at the moment with a number of former Ministers being engaged as consultants by the private sector to deal with their former agencies, or advising on policy issues relating to their former portfolio responsibilities. There has been concern expressed in the Parliament about the absence of protocols in this area. By request, the ANAO recently undertook an examination of a grant of \$5 million from the former Minister for Health and Aged Care to the Royal Australian College of General Practitioners (RACGP) to assist in the co-location of GP House⁵⁰.

Within agencies involving close interaction with the private sector, the question of the value of intellectual property and commercial-in-confidence information is also increasingly subject to probity considerations. Probity advice is crucial in the conduct of large-scale privatisations and outsourcing.

The concept of accountability is not exclusive to the public sector. No one doubts, for example, that the boards of private sector corporations are accountable to their shareholders who want some kind of return on their investment. It is the nature and extent of that accountability which public sector commentators would contend distinguishes the two sectors. As one commentator posits:

In the public sector, audit is required by citizens through Parliament to maintain confidence in the probity, and regularity of financial transactions and the attainment of best value from public expenditure, which contrasts with the private sector's need to give confidence to the capital markets.⁵¹

Of note, it is the adoption or adaptation of private sector approaches, methods and techniques in public service delivery, which has highlighted trade-offs between the nature and level of accountability and private sector cost efficiency. Accordingly, the essential issue, as is so often the case in public administration, is to achieve an appropriate balance between accountability and efficiency given the particular parameters of the situation at hand. Achieving this balance is imperative when the convergence of the private and public sectors focuses attention more sharply on both the similarities and the differences between the two.

Focus on results

The changing public sector environment calls for a more pragmatic approach to accountability. While the accountability regime should not stifle innovation or other management activity, it is important that appropriate mechanisms are in place to ensure the ethical and accountable use of resources. These mechanisms will vary depending on the particular business risks of individual program areas. While the business environment is changing, and the processes needed to effectively perform change accordingly, in my experience, one tenet remains constant: sound process leads in most cases to sound outcomes. This lesson is worth reiterating at a time when managers are apparently being urged to focus almost solely on outcomes or results, or at least this is a common perception. Some argue that a sound process can be a good result in itself. However, organisations do need to have clarity about means and ends.

The focus on results has also heightened the importance placed on rigorous performance information systems capable of quantitatively and qualitatively measuring results and demonstrating achievement. This is a major issue worldwide. Under the accrual budgeting framework in Australia, agencies are required to define inputs, outputs and outcomes. Under the Commonwealth legislative framework, agencies are also required to demonstrate the efficient, effective and ethical use of resources. Performance information is therefore essential to the achievement of statutory accountability requirements defined by the Parliament. The quality of performance information has been subject to a number of audits that have found substantial shortcomings in many important areas as agencies adjust to the new budgeting and accountability framework.

The ANAO reviews performance information as a matter of course in most performance audits. This includes review of the *appropriateness* and comprehensiveness of the relevant performance measures. In addition, a Better Practice Guide was produced in 1996⁵² and has been recently updated in relation to performance information in Portfolio Budget Statements⁵³. While recognising that good performance information involves time and cost considerations, this is an area with substantial scope for improvement. The benefits of cost effective performance information include the capacity to better manage risks, to adjust programs to meet changing client needs, and to demonstrate to Parliament that Commonwealth resources have been used efficiently and effectively. In that respect, I will be interested to review a model for rating departmental performance reports developed by my colleague the Auditor General of Canada. The latter observes that rating a department's performance report enables Parliamentarians to:

- compare the report with those of other departments that have also been rated;
- ask the department to take specific steps that will improve its report; and
- assess the department's progress in improving its report if it has been rated previously.⁵⁴

Materiality

Like its client agencies, the ANAO is also charged with getting the balance right between efficiency and accountability to best target its service to Parliament. An

analysis of materiality assists us in setting our strategic audit coverage from year to year. Materiality is the technical term for the threshold for determining the seriousness with which auditors will regard information which, if omitted, misstated or not disclosed, has the potential to affect adversely decisions made by users of a financial report about the allocation of scarce resources or by the management or governing board of an entity in the discharge of their accountability to stakeholders. To aim to detect all errors or misstatements would be cost prohibitive. However, materiality is important in relation to the issue of fraud or waste of taxpayers' funds, which is of concern to all our stakeholders, especially Parliament, and consequently is an ongoing focus for our work.

The ANAO takes a risk-based approach to the identification of fraudulent behaviour across the whole of government. It is fair to say that both the public and private auditing standards require an audit to be designed to obtain reasonable, but not absolute, assurance that a material misstatement due to fraud will be detected. There is no guarantee that we will detect all incidences of fraud. However, we aim to ensure that our approach gives us adequate coverage of areas of risk.

For 2001-02, the level of materiality adopted by the ANAO in planning for the Consolidated Financial Statements (CFS) audit was approximately 5 per cent of the average net results for the CFS over the previous 3 years, or \$400m. I acknowledge that this is a figure that gives some concern to a number of Parliamentarians. However, to make the most efficient use of our resources in providing a high level of service to Parliament the ANAO must take such a risk-based approach.

This does not mean that issues identified as less material for the purposes of financial statement audit are immune from review by the ANAO. In the event that financial statement auditors have concerns with matters arising in the course of an audit, they are encouraged to bring those concerns to the attention of their team leader, who can consider whether to examine the issue further as part of the audit, or whether to defer it to a subsequent audit or, if appropriate, and it is an issue likely to apply to a number of agencies across the APS, consider referring it for an assurance or performance audit. Currently, in Australia, increased attention is being given to the issue of potential fraud due to the introduction of a new auditing standard that explicitly requires auditors to consider, document and communicate with management on the issue of fraud. For example, there would need to be assurance of the existence of fraud control plans and that detected fraud is brought to attention. However, there is still no expectation that all fraud would be detected by an audit. The standard (AUS 210) states that:

*The primary responsibility for the prevention and detection for fraud and error rest both with those charged with the governance and the management of an entity.*⁵⁵

Adding value through audit

Our risk-based approach to setting our audit strategy allows us to target areas of most interest and value to the Parliament and the APS. We remain responsive to the needs of a changing public sector and endeavour to ensure that better practice and lessons

learned in individual agencies both in Australia and overseas are disseminated across the APS. In recent years, we have responded to the trend towards New Public Management (NPM) with a series of products focussing on the challenges and opportunities inherent in the NPM approach. Recent audits have covered, among other things, outsourcing, asset sales, contract management and networked service delivery.

- *Outsourcing*

A feature of the changing public sector environment has been the outsourcing of many functions that, it is judged, the private sector can undertake more efficiently and cost-effectively than the public sector. Outsourcing advocates point to the opportunities offered in terms of increased flexibility in service delivery; greater focus on outputs and outcomes rather than inputs; the freeing of public sector management to focus on higher priority activities; encouraging suppliers to provide innovative solutions; and cost savings in providing services.

There have been some successes, for example, the outsourcing of human resource management functions in the Department of Finance and Administration was assessed as positive for the agency's core business, and the agency won a worldwide outsourcing achievement award.⁵⁶ In addition, a recent audit of the management of Commonwealth national parks found benefits both in terms of savings to the Commonwealth and in increased employment opportunities in some rural and remote communities⁵⁷.

However, outsourcing also brings risks. My Office's experience has been that a poorly managed outsourcing approach can result in higher costs, wasted resources, impaired performance and considerable public concern. For example, an ANAO audit of the implementation of IT outsourcing across the public sector found that benefits realised by agencies were variable and that costs were well in excess of the amounts budgeted⁵⁸. A subsequent inquiry into the issues raised by the ANAO noted that:

*Priority has been given to executing outsourced contracts without adequate regard to the highly sensitive risk and complex processes of transition and the ongoing management of the outsourced business arrangement.*⁵⁹

The main message from this experience is that savings and other benefits do not flow automatically from outsourcing. Indeed, the outsourcing process, like any other element of the business function, must be well managed to produce required outputs and outcomes and must be suitably transparent to protect public accountability. Nevertheless, the increasing private sector trend to so-called 'smartsourcing' to meet a specific business need, as opposed to cost savings or avoiding difficult recruitment and retention problems, needs to be looked at in the public sector.

In addition to the immediate impact of outsourcing on public accountability, the transition to outsourcing arrangements has other significant effects over the longer term. For example, there is a particular risk that incumbency advantage may reduce the level of competition for subsequent contracts. Incumbents may have greater information and knowledge about the task than either potential alternative service providers or the

Commonwealth agency directly involved. The risk becomes more pervasive when the outsourced activity has a significant impact on core business, or where competition in the market is limited.

The customer relationship with the business also changes following outsourcing. It is important that the ongoing customer relationship is subject to appropriate pricing arrangements and that private sector competitors are given the opportunity to bid for government business. In the appropriate circumstances, the use of competitive tendering and contracting promotes open and effective competition by calling for offers that can be evaluated against clear and previously stated requirements to obtain value for money. This, in turn, creates the necessary framework for a defensible and accountable method of selecting a service provider. In addition, it should facilitate the best outcome for customers who, it should be noted, are also taxpayers and citizens.

The convergence of the public and private sectors will continue to introduce new levels of complexity and risk to public sector agencies. Managing the new risks is crucial to the achievement of value for money – the primary gain from involving the private sector in the first place. Convergence has many different dimensions and involves a wide range of stakeholders including both non-government and community players. As discussed earlier in this paper, agreeing governance structures and demonstrating accountability are particular challenges in the new business environment. Agencies can outsource functions - in full or in part; however, Parliament insists that they cannot outsource their responsibility or overall accountability. The Government recently reinforced this point in noting that:

agencies remain accountable for the delivery of services, even where the service delivery is provided by the private sector. Central to the accountability principle is the need to maintain awareness of client needs and how they are being met.⁶⁰

Yet, practically, there is a question of just how accountable agencies can be, in the traditional meaning of the concept, if they have virtually no responsibility for the delivery of particular public services nor relevant information or experience. This issue has obvious implications for the ability of Parliament to scrutinise the efficiency and effectiveness of outsourced operations.

At the end of the day, it may be the courts that determine accountability for outsourced business activities. There have already been cases where the courts have ruled on the ultimate accountability of government agencies for outsourced activities, and the ANAO is currently assisting with such a matter that is before the courts.

- Asset sales

A key issue in my performance audits of the sale of Commonwealth assets – particularly Commonwealth businesses – has been the role of financial, legal and other private sector advisers in the sale process. In Australia, the privatisation process itself is now subject to extensive outsourcing under multi-million dollar advisory contracts. This places considerable emphasis on contract management and balancing commercial

interests with the overlaying public accountability requirements of the public service. One of the key outcomes from our privatisation audits has been the identification of opportunities for significant improvements to both the tender process and the management of the contract itself⁶¹. The implementation of improved processes can lead to improved overall value for money and project quality management in subsequent sales. In short, the emphasis is on better practice to add value to public administration as a major audit objective. As the Chief Secretary of the United Kingdom Treasury noted recently:

*We have a duty of care to the taxpayer to eliminate poor procurement methods and to ensure value for money improvements. For every pound saved in procurement is a pound more for front line public services like hospitals, education, fighting crime and investing in transport.*⁶²

Overall, there have been mixed results from the greater use of private sector practices. Some \$50 billion has been raised in asset sales, which has contributed to debt reduction and provided the funds for pressing policy initiatives such as environmental protection and community services in rural areas.

However, many public sector businesses were established to provide services or products that were important to the public interest. The sale of these businesses does not end the public interest in the provision of these services and products, and this is often reflected in ongoing regulation of the relevant business or industry. Accordingly, where government has seen a public interest need for the regulation of privatised companies or industries in which privatised companies compete, Auditors-General can perform an important accountability function in examining and reporting on the public sector's performance in regulating privatised businesses and / or administering government contracts with these businesses. This is an important accountability mechanism for the Parliament.

- Contract management

I noted earlier that sectoral convergence highlights the fact that there remain (necessary) differences that are often reflected in the area of contract management. By contract management, I mean the whole process from the initial release of tenders through to ongoing contract performance monitoring and review, including transition arrangements. The nub of these differences is that taxpayers' dollars are at stake. It is crucial that the process of awarding contracts is adequately documented, ensures open and effective competition, and achieves value for money outcomes. The process must be transparent and able to withstand parliamentary, and other, scrutiny.

Contracts must include clearly specified qualitative and quantitative performance standards. They should include appropriate arrangements for monitoring and reviewing contractors' performance. It is important that the ongoing business relationship between the public sector and the privatised business is defined by a legally enforceable agreement. The written contract must accurately reflect the understanding of all parties to the contract, and must constitute the entire agreement between the parties. Should

this not be the case, the documentary trail supporting the authority for the payment of public money, the contractual performance requirements, incentives and sanctions may not be clear. The Government has acknowledged the importance of giving greater attention to this aspect of public administration. In its response to the JCPAA's review of contract management in the public service, the Government noted:

*the importance that contract management now assumes in the ... APS and the enhanced benefits that it can offer. The Government is also keenly aware of the importance of transparency and accountability when managing Government contracts.*⁶³

Just as it is incumbent upon public sector agencies to ensure that they have a sound understanding of the commercial nature of any contract, private sector entities entering into commercial relationships with the Commonwealth need to recognise that there are overlaying public accountability issues that need to be addressed that may not normally be pertinent to purely private sector transactions. Contractual performance is maximised by a cooperative, trusting relationship between the parties. This may take some time to secure. However, it should never be forgotten that such relationships are founded on a commercial basis in which the parties do not necessarily have common objectives. Accordingly, good commercial practice requires a contractual framework appropriate to the business relationship. That is, one size does not fit all.

Importantly, there should be no equivocation about either the required performance or the obligations of each party. I stress that this is as much about achieving the desired outcome as it is about meeting particular accountability requirements. In an article quoted earlier, reference was made to a recommendation, in relation to Victoria, that a two-tiered system of performance measurement be adopted.⁶⁴ While not the first time this approach had been suggested, the main idea was that, first, a series of quantitative measures be developed against which contractual performance measures should be assessed. Second, a series of additional measures, both quantitative and qualitative, would also be developed which would act as more general indicators of performance by a private sector provider. The notion is that these latter measures, while not directly enforceable through the contract, may be made available publicly to enhance program accountability.⁶⁵

In large part, the foregoing is a reflection of a concern about the nature of accountability in public/private partnerships. The recently released Commonwealth Fraud Control Guidelines require agencies to take care that outsourcing does not compromise the agency's fraud control arrangements by putting in place measures to ensure external service providers meet the high standard of accountability needed as part of the Commonwealth's procurement framework⁶⁶. There are lessons to be learned by both sectors in this important area of the governance framework.

The ANAO has produced a number of audits and two better practice guides on the issue of contract management in an attempt to assist agencies and their private sector partners in this very complex and fast-growing area. The JCPAA has also reviewed this issue and its implications for public sector accountability. In its recent review of the *Auditor-General Act 1997* (referred to in the first section of this paper), the JCPAA stated that:

*the increasing role of the private sector in the provision of public goods and services requires an administrative mechanism to ensure the Auditor-General has access to the premises of Commonwealth contractors. The Auditor-General requires this power to obtain documentation and information to arrive at an opinion about the efficiency and effectiveness of program administration.*⁶⁷

I consider that access to contract related records and information should generally be equivalent to that which should reasonably be specified by the contracting agency in order to fulfil its responsibilities for competent performance management and administration of the contract. Access to premises would not normally be necessary for 'products' or 'commodity type' services, such as maintenance and cleaning, which are provided in the normal course of business. It would be a different matter where government information or other significant assets were located on private sector premises.

The JCPAA has stated that standard access clauses should be included in all government contracts unless there are strong reasons not to. The Committee resolved, as part of its power to review and change the Annual Report Guidelines, that it will require government agencies to include in their Annual Reports a list showing all contracts by name, value, and the reason why the standard access clause, which provides the Auditor-General with access to the premises of Commonwealth contractors, was not included in the contract.⁶⁸ This provides Parliament with the opportunity to scrutinise agencies regarding their decisions.

While the Government has yet to respond to this Report, it stated, in response to an earlier JCPAA recommendation, that:

its preferred approach is not to mandate obligations, through legislative or other means, to provide the Auditor-General automatic right of access to contractors' premises

and that

*the Government supports Commonwealth bodies including appropriate clauses in contracts as the best and most cost-effective mechanism to facilitate access by the ANAO to a contractor's premises in appropriate circumstances.*⁶⁹

The response also stated that:

*the Commonwealth Procurement Guidelines would be amended to emphasise the importance of agencies ensuring they are able to satisfy all relevant accountability obligations, including ANAO access to records and premises.*⁷⁰

While noting the Government's response, the ANAO continues to encourage the use of contractual provisions as the key mechanism for ensuring agency and ANAO access to contractor's records for accountability purposes. The ANAO and the Department of Finance and Administration developed a set of standard access clauses which the Minister for Finance and Administration approved as part of the revised Procurement Guidelines issued in September, 2001⁷¹. More recently, use of such clauses by agencies, on a case by case basis, was re-endorsed by the Government's response⁷² to the JCPAA's Report on Contract Management in the Australian Public Service mentioned earlier. The Government went on to note that:

*In addition to these formal measures, the ANAO might also consider the development of an information package for agencies, which gives practical examples of best practice and illustrates the benefits to agencies in negotiating appropriate provisions with their contractors. However, as an independent agency, this is a matter for the ANAO.*⁷³

We are looking again at what further direct and indirect support we can provide to agencies in this respect.

This is an issue that is currently challenging the private sector also. The regulatory body for the major banks has recently expressed reservations about its ability to review the administration of credit cards, for example, that may have been outsourced to third parties. The Australian Prudential Regulatory Authority (APRA) has drafted new rules covering outsourcing which will give it the power to impose terms and conditions on such contracts, as well as to conduct on-site inspections⁷⁴.

Contract management experiences were positive, for example, in relation to the construction of the National Museum of Australia (NMA), which was recently reviewed by my Office. In late 1996, the Government announced its commitment to establish new facilities for the NMA and the Australian Institute of Aboriginal and Torres Strait Islander Studies in Canberra. The project was allocated a budget of \$155.4 million and the Government decided to pursue a project alliancing strategy to achieve time, cost and quality objectives in the construction of both facilities. Project alliancing is a relatively new method of contracting that seeks to deliver a cost-effective outcome within a set time frame for a project through which the project owner – in this case the Commonwealth – shares project risks and rewards with the contractors.

The ANAO found that, overall, the contract management process was well handled by the Department of Communications, Information Technology and the Arts (DCITA). The process for the appointment of architects, building and service contractors, and exhibition designers complied with the Commonwealth procurement guidelines. The development and use of probity guidelines in the selection processes added valuable assurance. Successful project alliancing depends on skilful management of the particular risks involved. With respect to this project, the ANAO considered that appropriate financial incentives were in place to encourage 'best for project' behaviour from both the Commonwealth and its commercial alliance partners.

The ANAO also found that DCITA and its commercial alliance partners had sound processes and procedures in place to monitor appropriately the progress of construction and manage time, cost and quality requirements. Overall, the ANAO considered that DCITA managed the project well having regard to the project's magnitude, the agency's lack of experience with the relatively new project alliancing approach and the tight timetable involved. The management of the construction of the NMA demonstrates the advantages of robust contract management in achieving value for money outcomes.⁷⁵ Importantly, there was shared understanding about what the latter involved for the partnership.

Managing the risks associated with the increased involvement of the private sector in the delivery of government services, particularly through contract arrangements, has required the development and/or enhancement of a range of commercial, negotiation, project and contract management skills across the public sector. Risks to be addressed by agencies include external risks such as legal issues, policy changes, contractor business failure and internal risks, such as lack of appropriate skills/knowledge for awarding and managing contracts, failure to meet performance targets, and management information system failures. These risks need to be analysed prior to the commencement of the contractual relationship as well as during the life of the contract. By using a sound risk management approach to support contract management, corporate governance is enhanced and, consequently, there is a greater assurance that the risks are managed effectively. This is one of the major challenges facing contemporary public sector managers in demonstrating accountability to the Parliament.

- Networked service delivery

The ANAO has also sought to add value through its audit activity in the area of networked service delivery. As discussed earlier in this paper, agencies are increasingly making use of new forms of partnerships with both public and private sector counterparts to enhance service delivery. We now operate within an 'accountability continuum' that accommodates the wide variety of approaches implemented by individual agency heads, or agency heads in partnership, to meet their objectives. The ANAO has sought to provide guidance in relation to better practice and lessons learned in this complex field.

The ANAO's audit of the management of Job Network contracts examined the effectiveness of a network of 300 private, community and government provider organisations in finding jobs for unemployed Australians.⁷⁶ The ANAO found that the first round of Job Network contracts had been managed in an efficient and effective manner, however, there were some areas for improvement. In particular, the audit focussed on an issue worth considering by all agencies entering into networked relationships – that is, the need for regular communication on strategic, higher level issues between responsible agencies and their network partners. While the ANAO made recommendations aimed at enhancing some aspects of contract management, it also considered that the Job Network afforded better value for money than previous employment assistance arrangements. The lesson is that networked arrangements can offer a range of benefits in terms of enhanced service delivery provided they are appropriately managed.

Similarly, the ANAO examined the effectiveness of networked service delivery in its review of Commonwealth Emergency Management Arrangements.⁷⁷ Although the protection of life and property is a State responsibility under the Constitution, the Commonwealth has significant involvement in national emergency management arrangements through its planning, coordination, financing, education, training and research activities. Many cooperative arrangements have been implemented between the Commonwealth and the States and Territories with the aim of advancing public safety objectives. At the time of the audit, the ANAO found that there was no whole-of-government approach to Commonwealth emergency management. While stakeholders considered that individual Commonwealth agencies were meeting the needs of the community, they also identified the need for greater attention to strategic issues. The ANAO found, among other things, that coordination of Commonwealth emergency management could be more effective if interdepartmental coordination arrangements were made more transparent and better directed. As is so often the case, the audit identified the need for rigorous strategic planning, and ongoing monitoring and review, to enhance agencies' capacity to achieve the outcomes specified by Parliament.

The trend toward 'networked' or cross agency approaches is one that is likely to continue as agencies take advantage of the opportunities offered by more responsive service delivery mechanisms. Both Parliament and the ANAO will have an important role to play in setting accountability standards and helping to define appropriate governance frameworks. At the very least, there should be recognition that governance issues need to be given greater prominence and consideration.

For example, it may be deemed appropriate for governance arrangements to be set out in Cabinet submissions where cross agency issues arise. Alternatively, governance committees could sit above individual administering agencies and take responsibility for collective outcomes. Such committees should set out and review objectives and performance measures to ensure that agencies are achieving required results. Governance arrangements may be formal or informal but should be clearly set out and reviewed. They may range from formal Boards through to informal Committees; they may be formalised through MOUs or may be the sole responsibility of a lead agency. The important thing is that someone takes responsibility for accountability and governance to provide assurance as to the stewardship of public resources.

This is particularly important for demonstrating program outcomes. For example, in the recent audit of the Federation Fund (mentioned earlier) it was noted that, where more than one agency is responsible for delivering the Government's program objectives, the concept of whole of government performance reporting through the identification of a 'lead agency' is an area for improvement in Commonwealth reporting and accountability⁷⁸. In relation to the Federation Fund, reporting only in individual agencies led to a 'silo effect' that should be avoided in the future through more comprehensive reporting of overall outcomes. This is a generic issue worthy of further consideration given the trend towards cross agency and whole of government approaches.

3. HOW THE ANAO ASSISTS PARLIAMENT AND THE APS

Like all public sector agencies negotiating the challenges of the changing governance environment, the ANAO has modified its own business practices to respond to new needs and directions. The ANAO has responded to the changed environment on two levels: both strategically and tactically. On the strategic level, we have given renewed attention to relationship management and well-targeted products and services. On the tactical level, we have focussed on ensuring that our work continuously improves as we demonstrate accountability to Parliament.

In recent years, the ANAO has strengthened its assurance function and extended its advisory role. By reinforcing its traditional functions, while remaining open to new approaches and innovation, the ANAO is well placed to lead and guide in partnership with the Parliament in the contemporary public sector environment. We are committed to a more responsive and strategic risk-based audit approach. Our goal is to have relevant products that are state of the art. Our ability to compare operations across the public sector, as well as our statutory independence are our strengths.

The challenges that the Commonwealth public sector is currently facing are not unique. The trend towards the convergence of the public and the private sector is also underway in many countries, such as Canada, the UK, the US and New Zealand. It is important that my Office continues to participate actively in debates around the complexities of the changing public sector environment and their resolution. In this respect, a dynamic relationship with the Parliament is vital.

Focus on relationships

Relationship with the Parliament

Independence is important for the ongoing credibility of the Auditor-General but, it should also be noted, so are meaningful relationships with a range of stakeholders. The most important of these, in terms of our ongoing relevance, is our symbiotic relationship with the Parliament.

As noted earlier in this paper, the ANAO regards its primary client as the Parliament. Indeed, it could be argued that, given our proximity to the day-to-day operations of the APS, we are Parliament's 'eyes and ears' on Commonwealth administration, particularly in a devolved NPM environment. We take this responsibility seriously, as the support of the Parliament for the work of the ANAO is vital. The ANAO could not continue to be relevant without Parliament supporting our audit work program, our recommendations, and assisting us in determining appropriate accountability standards for the APS.

Relationship management is important to us. Indeed, such is the strategic importance of meeting our clients' needs, it comprises the first of our four key results areas. Our

objective is to satisfy the needs and expectations of the Parliament, the Executive Government and our audit clients in relation to performance assurance and accountability. We aim to do this by, among other things, enhancing our dialogue and relationship with all members of Parliament, particularly the JCPAA and other Parliamentary Committees, so that they are well informed about our activities and so that we, in turn, can provide them with timely and constructive assistance.

As part of its regular business, the ANAO provides briefings to Ministers, Shadow Ministers, Parliamentary Committees and their staff on audit reports tabled in the Parliament. ANAO officers also liaise closely with Committees, and staff may be seconded to assist Committees with more complex matters. Senior executives at the ANAO have individual targets for Parliamentary liaison, and the Office as a whole has performance targets linked to the satisfaction of Parliament. For example, each year we aim to have JCPAA support for all of our reports tabled in Parliament. We aim to have 95 per cent of our recommendations supported by the JCPAA and other Parliamentary Committees.

The ANAO works hard to ensure that we are meeting Parliament's needs. We monitor our progress in this regard by analysing the results of client satisfaction surveys, and building a strong and effective relationship with the JCPAA and other Parliamentary Committees. As well as guiding us in targeting and refining our annual audit work program, the JCPAA is, however, the main channel for formal dialogue between the ANAO and the Parliament.

Recent years have seen an increasing tendency to direct requests by Ministers for audits of particular programs or issues. While this represents a useful measure of our ongoing relevance and credibility, it also has the potential to challenge the issue of the Auditor-General's independence. The Office must ensure that, where direct requests for audits are accepted, such audits are in the public interest. Direct requests for audits are also considered in light of the planned audit work program and potential resource implications. That program is developed annually against the background of the APS environment, including the business risks that are likely to impact on the APS during the period under review. These risks are taken into account in identifying themes, such as contract management, to be addressed in the work program. The intention is to provide Parliament with an assurance, over time, of the performance of all public sector agencies.

The key conduit for ongoing Parliamentary input to our work is the JCPAA. The JCPAA is responsible for bringing together issues of Parliamentary interest for consideration in the ANAO's planning processes. As discussed earlier in this paper, the JCPAA also has an important ongoing role through its scrutiny of our reports in providing assurance that our activities are covering the 'right' ground from a parliamentary perspective. The basis of selection of audits and their coverage are comprehensively set out in our annual audit work program, which is made available to all Parliamentarians and agencies.⁷⁹ As well, we table two Audit Activity Reports each year in Parliament, which provide a summary of audit outcomes for the previous six months.⁸⁰ All such documents are included on our web site. These are part of our policy of 'no surprises'.

Relationships with APS agencies

It is vital that the ANAO continues to be an active participant in the public sector's negotiation of the changed governance environment. While in the past the ANAO's prime focus may have been on ensuring compliance with legislation, this has now been subsumed as part of a broader approach to assist agencies in improving public sector administration. To be successful, this approach requires considerable cooperation between my Office and the agencies and other bodies with which we deal. This means that links are constantly being formed and strengthened with our major clients.

Our relationships are managed responsively and there is no single method for success. The ANAO's clients are extremely varied, and this necessitates tailored approaches. Audit bodies can no longer afford to take the traditional 'big stick' approach, although the need for powerful independent review bodies supported by robust legislation should also not be understated in the current climate. However, the ANAO emphasises the importance of building strong relationships with agencies and other stakeholders to foster a culture of accountability in preference to a more prescriptive approach. We aim to focus on outcomes and results to provide products and services that suit the needs of both the audited agencies and the Parliament.

We encourage agencies to make early contact where they are faced with new or difficult administrative issues. Our experience across a range of issues both in Australia and overseas allows us to assist agencies in understanding the opportunities and risks inherent in diverse management approaches. We are always mindful, however, of the need to maintain our independence whilst assisting agencies at the 'front end'. As noted earlier in this paper, it is for public sector managers to make their own decisions on whether or not to accept ANAO advice based on the particular risks and opportunities operative in their business environments.

It is crucial that we work cooperatively with agencies at all stages of the audit process to gain genuine acceptance of our recommendations. This is essential if we are to add value and maintain our credibility. Our preferred approach is to give agencies encouragement, and to acknowledge and reinforce any action taken in the course of audits. We endeavour to meet formally and informally with agency top management throughout the year. In particular, we promote their interest and involvement at the start of each audit and in our planning processes, notably in our audit strategy statements for individual agencies and in our Audit Work Program, referred to earlier. Finally, we aim to meet our clients' needs by periodically reviewing the relevance and mix of our products and services, striving for innovative approaches and improving our quality and effectiveness. The above initiatives are aimed at securing the engagement and commitment of all stakeholders to our work.

Products - designed to be relevant and state of the art

In order to meet our clients' changing needs, the ANAO has moved towards a more strategic, risk-based audit approach. Our goal is to add value through audit products that are state of the art. We encourage innovation within a clearly defined auditing standards framework. The ANAO is committed to working closely with our national and international colleagues to ensure that we remain at the leading edge and that we have the right mix of assurance, compliance, accountability, and performance products at any point in time and over time.

Audit product continuum

ANAO audit products run the continuum from high-level performance audits that may target particular issues across the APS, to the traditional financial statement and financial control and administration products that provide assurance as to the stewardship of public funds in individual agencies. In addition, the ANAO disseminates better practice through a series of Better Practice Guides, AMODEL and Business Support Process Audit reports on a range of issues challenging the contemporary APS. Our reports are authoritative and our annual audit of the Consolidated Financial Statements and our assessment of agency control structures, for example, provide a unique overview as to the ongoing financial performance of over 200 Commonwealth entities.

In addition to leveraging off our Australian and international colleagues, the ANAO is committed to an integrated auditing framework that draws on the strengths of each side of our business; that is, financial (assurance) and performance audits. These audits are tailored to the assessed situation (needs) of public sector organisations. The approach capitalises on intelligence gathered in each field and allows us to target areas for audit activity that add most value. In addition, it allows us to assess the value of our products over time, and to fine-tune our outputs. Our objective is to deliver high quality audit products that maintain and improve the high standards and professionalism of our audit and related services.

Cross portfolio audits

The ANAO is uniquely placed to provide an analysis of performance across the public sector, as indicated earlier. This is important as agencies increasingly find new methods to deal with common issues, and form alliances and partnerships, including with the private sector, to deliver government services. In considering the future of the Australian Public Service, the Prime Minister has indicated that:

*Whole of government approaches, collectively owned by several Ministers, will increasingly become a common response.*⁸¹

Recent years have seen an increase in the number of 'across the board' and cross-portfolio audits undertaken that compare experiences in a range of agencies. For example, the ANAO has recently undertaken cross portfolio analysis of, among other things, internet security, the management of bank accounts, and performance information in Portfolio Budget Statements. Our ability to compare operations across the public sector, and sometimes the private sector, as well as our statutory

independence, are significant strengths and add value to a wide range of stakeholders.

Promoting better practice

In terms of getting the 'right mix' for the contemporary environment, my Office has fine-tuned its focus on products that add value by bringing together lessons learnt across the public sector. In particular, our benchmarking studies and Better Practice Guides (BPGs) have been well received by program managers interested in learning from the experiences of others. BPGs serve a dual purpose: they provide a unique analysis of trends affecting the public service as a whole; and they provide a very valuable source of audit criteria for future work in related fields. BPGs aim to improve public administration by ensuring that better practices employed in individual organisations in Australia and overseas are promulgated to the whole of the public sector.

Depending on the subject and nature of information collected during an audit, BPGs may be produced in conjunction with a performance audit or what we now term Business Support Process audits. Alternatively, a BPG might be prepared as a result of a perceived need to provide guidance material in a particular area of public administration. Recent BPGs produced cover a wide range of topics including: grant administration; contract management; planning for the workforce of the future; internet delivery decision-making; AMODEL non-commercial authority financial statements; life cycle costing; rehabilitation issues; and developing policy advice.

In terms of benchmarking services, our products currently comprise functional reviews of the major corporate support areas. The overall results of these reviews are published generically and tabled in the Parliament. At the audit client level, a customised report is provided to all entities participating in the benchmarking study. Our most recent benchmarking studies have covered the following areas: the implementation and production costs of financial management information systems; the finance function; and the internal audit function. We are soon to release a study on Human Resource Management. Finally, as well as benchmarking and analysing public sector performance, we compare our own performance to that of our peers in Australia and internationally.

Follow-up audits

Until 1999, there was a requirement for Portfolio Ministers to submit periodic reports to the Minister for Finance and Administration to report on action taken on matters raised by the Auditor-General in ANAO audit reports. As part of this process, the Department of Finance and Administration undertook an assessment of the adequacy of these actions. The Prime Minister devolved this responsibility to agency heads in 1999, and there is now no formal requirement for the progress of implementation of ANAO recommendations to be reported in Parliament⁸². However, it is recommended that entities provide to the ANAO and the JCPAA copies of regular reports or follow-up action on these matters, including a suggested model of a suitable follow-up process.⁸³

The ANAO works closely with the various audit committees of public sector organisations to monitor the implementation of its recommendations. However, as discussed earlier, the most effective action is the JCPAA's quarterly public hearings on selected audit reports and any JCPAA inquiry conducted as a result of these reports. The ANAO also conducts its own follow-up audits to monitor the implementation of recommendations, as well as to report on any other emerging issues that may be of interest to Parliament. It is important to us that our recommendations are both accepted and implemented, and that Parliament and agencies consider that our audit activity adds value to public sector administration.

Real time auditing

The ANAO seeks to assist agencies expeditiously, and both technological developments and responsive relationship management can assist us in this. The trend towards 'real time' or 'early intervention' auditing, as discussed earlier, may have some implications for audit independence. However, 'real time' products and services are also of increasing value to our audit clients and consequently require further analysis as part of our strategic planning processes. This is particularly the case in terms of our financial statement audit approach.

Over recent years, the timeframe for the preparation of financial statements by Commonwealth agencies has been significantly compressed. The *Charter of Budget Honesty Act 1998* requires that the Final Budget Outcome Report be tabled in Parliament by 30 September each year. To meet this deadline, the financial statements of all material entities must be prepared and audit-cleared by 15 August. This continues to pose significant challenges for all entities involved, including the ANAO.

Most major Commonwealth entities do not meet better practice standards. As noted in the most recent report on financial statements across the Commonwealth, entities took on average 60 days to produce signed financial statements.⁸⁴ This reflects the fact that a number of agencies are continuing to struggle to achieve 'hard closes'⁸⁵ prior to the end of the financial year. A 'hard close' is generally associated with the traditional 'close of the books' process for the production of financial reports for outside regulators. It typically involves performing reconciliations; searching for undetected accruals or transactions processed in the wrong period; verification of physical balances; and analysis of transactions and balances to detect errors arising from misclassification or misposting. It may also include obtaining independent appraisals and estimates for balances not able to be determined by other means. Better practice organisations undertake a 'hard close' only where there is an external, regulatory requirement to produce financial statements. For most Commonwealth organisations, this will be their annual financial statements.

To increase their capacity to meet the 15 August reporting deadline, agencies now aim to have as much of their financial statement preparation (including audit clearance) as possible finalised prior to 30 June. There has consequently been a shift away from peak workload periods by undertaking a 'hard close' before financial year-end, where entities are in a position to do so.

This is in line with the ANAO's BPG on Building Better Financial Management Support, which advocates a shift away from peak workload periods. The BPG also notes that world best practice organisations have reduced the total time for the financial statement preparation process to two days. Finally, it indicates that it is now common practice to produce financial reports within five to seven days of the end of the reporting period.⁸⁶ At this stage, both of these outcomes would be somewhat ambitious for most public sector organisations.

To move towards best practice, entities need robust accounting systems and processes in place that allow the performance of a hard close several months before the end of the financial year. The achievement of hard closes in March, for example, will continue to be encouraged. The development of improved accounting systems and processes will also ultimately mean more robust financial information for decision-making and management demand for hard closes on a regular basis throughout the year.

The achievement of these tighter timeframes by agencies also requires some shift in audit practices from *ex post* to *ex ante* or at least a real time audit process. This means that the ANAO has in many ways had to mirror its client agencies in terms of responding to the new time pressures on the production of financial statements. A shift to real time auditing can be more valuable to our clients as issues can be identified and brought to the attention of management early. Nevertheless, with the move to real time auditing we also need to remain conscious of the need to manage potential conflicts of interest. The early identification of issues for the attention of management is actively encouraged. However, care needs to be taken that auditors remain separate from the decision-making framework to protect their independence.

The need to maintain independence while remaining responsive to our clients' needs is also the reason that my Office has, to date, undertaken only a very small number of probity audits. It is my view that in terms of probity, the greatest value can be achieved from independent *ex post*, rather than *ex ante*, auditing. There may, however, be some areas where our experiences across the public service offer opportunities for promulgation of better practice in the development of systems and procedures. For example, my Office is currently planning a cross-portfolio audit of the use and effectiveness of Human Resource Management Information Systems in Commonwealth agencies.

Keeping Parliament and the APS informed

Accessibility

The ANAO aims to keep Parliament and the APS up to date on its ongoing audit activity – from the audit work program planning process right through to assistance to Committees of Inquiry established after publication. As well as working with Parliament and agencies on specific issues under review, we aim to be accessible to all stakeholders through a variety of forums. The ANAO website⁸⁷ has recently been enhanced to provide improved functionality and content. The website has links to all of our publications including audit reports, better practice guides and speeches. It includes a list of audits in progress, a tabling schedule, information on tenders and contracts,

recruitment details, and links to our national and international colleagues. The website incorporates information on relevant contacts for each of the business units, and a request form for further information.

In addition, the ANAO is pleased to provide briefings on particular issues or audit reports by request. This is an important way for us to enhance understanding of the complexities of the changing public sector environment, and also to secure direct input from Parliament and other stakeholders in terms of the redefinition of acceptable accountability frameworks for the twenty-first century.

As discussed earlier, we also welcome early contact from agencies faced with new or challenging administrative issues. While we are vigilant in terms of maintaining our independence, our access to a range of comparative experiences both in Australia and overseas can often assist. Finally, we aim to continue strong working relationships developed in the course of audits by remaining available to program managers beyond the formal audit conclusion. Agencies are increasingly maintaining contact as they implement ANAO recommendations and beyond, which is an important way for our officers to assess the ongoing utility of their work.

Liaison

In addition to the ‘ad hoc’ contact referred to above, the ANAO builds regular and ongoing liaison into its annual schedule of activities. The most important of these, in terms of setting strategy for the Office over successive financial years, is the development of the ANAO’s audit work program. There is obviously little discretion about the financial statement audits. However, audit topics are generally selected on two grounds: the capacity of an audit to add the greatest value in terms of improved accountability, economy, efficiency and administrative effectiveness; and the desire to ensure appropriate coverage of entity operations within available audit resources. Annual themes are used in selecting topics to ensure that the audit program is targeted appropriately to add value to public administration. An important part of this planning process is the early engagement of stakeholders including agency heads and the Parliament, through the JCPAA, to ensure that the work program is optimally targeted.

The other key focus for our ongoing liaison work is the assistance provided to Parliamentary and audit committees. As discussed earlier in this paper, ANAO officers provide significant assistance to Parliamentary committees charged with reviewing matters relevant to ANAO audit reports. To this end, a number of ANAO staff are seconded each year to assist committees with more complex inquiries over longer periods of time. Audit managers and senior executives also attend audit committee meetings within those agencies for which they are responsible. This is an important medium for the exchange of information and ideas, and assists us in fine-tuning our work over time. Finally, as mentioned earlier, senior executives at the ANAO have targets for Parliamentary liaison built into their individual performance agreements. Our ultimate aim is to be accessible to Parliament and the APS to enhance the reach and significance of our work and to maintain our relevance and credibility.

Demonstrating accountability to Parliament

Annual Report

The ANAO's annual report is the most public and comprehensive mechanism for demonstrating accountability to the Parliament. We aim to include an analysis of our achievements to date, as well as challenges outstanding for the future. In this way, we provide Parliament with a comprehensive overview of our performance over the preceding financial year and an indication of areas of interest for the future.

The Annual Report includes an assessment of the Office's achievements against its annual scorecard. The scorecard incorporates the ANAO performance indicators set out in its Portfolio Budget Statements. Performance measures relate to three Output groups: performance audit services, information support services and assurance audit services. These link back to the ANAO's twin Outcomes: improvement in public administration and assurance. The scorecard includes both quantitative and qualitative measures and is intended to provide interested parties with an understanding of the link between the ANAO's products and their resulting impacts. It is then possible to assess how cost-effectively the ANAO is delivering its products and to what extent the ANAO is achieving its agreed outcomes. This provides Parliament with assurance that we have the right systems in place to produce reliable reports.

Each year, our Annual Report also includes results of quality assurance processes including peer review and benchmarking activities. It also includes commentary on the key strategic issues targeted by the ANAO for the next 12 months. This commentary, together with the publication of the results of our audits every six months in the activity reports, allows us to contribute to contemporary debate on a broad range of issues facing the APS. Importantly, it also provides a focus for ongoing discussion with the Parliament in relation to setting strategies for the future.

Client surveys

Another important performance management and assessment mechanism is the entity survey. After each performance audit is tabled, feedback on the audit process is sought independently from the senior manager responsible for the audited program by means of a questionnaire and interview. An independent consultant performs this evaluation. The results of the most recent survey were positive on the whole. Managers continued to support the ANAO's efforts to move to a more 'value adding' approach. They also referred to the value of ANAO reports and recommendations in providing assurance and in providing leverage to facilitate particular activities. The entity survey is one of the most direct ways we have to test that our ongoing commitment to relationship management is achieving results.

In addition, as well as the regular contact that we have with the JCPAA and other Parliamentary Committees, the ANAO conducts face-to-face surveys of parliamentarians. These surveys are conducted periodically to ensure that we are hitting the mark in terms of our product mix. This ensures that we will continue to be able to respond to the challenges of the future, and that we have a shared understanding of appropriate standards of accountability to lead and guide agencies into the future.

External scrutiny

As well as our internal review and quality assurance procedures, the ANAO is subject to several layers of external scrutiny, including those applying to all other APS entities. The most important of these, in terms of demonstrating our accountability to Parliament, is the JCPAA. The JCPAA reviews all of our reports. Consequently, a strong and dynamic relationship with this Committee, as our main point of contact with the Parliament, is crucial to our ongoing viability. I have also previously mentioned the scrutiny and assessment by entity audit committees. As well, we are under constant challenge by agencies to justify our decisions and our findings. All our products are subject to public scrutiny and included on our web site, as noted earlier.

The Independent Auditor of the ANAO carries out both the audit of the ANAO's financial statements and selected performance audits of the ANAO. The Act (Section 43) requires the Independent Auditor to have regard to the audit priorities of the Parliament as determined by the JCPAA, in the conduct of performance activities. Performance audits conducted over the years range from an overall assessment of the economy, efficiency and effectiveness of the Office^{88,89}, our human resource management⁹⁰, benchmarking of our performance⁹¹, our strategic planning framework⁹², our planning and resource allocation processes⁹³, and our audit management processes⁹⁴.

4. CONCLUDING REMARKS

The ANAO supports the Parliament in holding the Executive to account as part of the democratic process, while at the same time helping agencies to improve their performance in the changing accountability environment. While our independence is an essential element of our work, we can only meet our objectives if we earn the trust and respect of the Parliament. Clearly, we have that respect, and we will continue to work hard through ongoing quality assurance and review to ensure that the relationship remains strong and positive. It is worth reiterating that we regard the relationship as symbiotic in that we provide vital support to Parliament in terms of our assessment of the quality of administration across the APS to inform its deliberations, while we also rely on Parliament for advice as to appropriate accountability boundaries and for ongoing priority-setting. Our advice and support is complementary and, it is to be hoped, mutually beneficial.

Because of the changing business environment we face in the public sector, auditing needs to be adaptive and alert to the risks involved to ensure that we target the issues of most interest and value to Parliament, the public and contemporary public sector

managers. The governance landscape has changed, and managers need access to better practice, leadership and guidance to ensure that their own business strategies are effectively determined and put in place. Our statutory independence, as well as our expertise across the board, gives us a unique position within the accountability framework. It is crucial that we capitalise on these strengths in setting our agenda for the future. That agenda will continue the assurance and advisory roles for which we are well known and respected. However, we will also need to ensure that we remain responsive to the emerging pressures on Parliament as well as our client agencies. The ANAO has been monitoring trends in public sector change and setting our responses accordingly. This ensures that our approach and coverage will continue to be relevant and add value.

The ANAO recognises the importance of being an active participant in the process of change. This allows us to target products that span the accountability continuum from the assurance based products for which we are traditionally known and on which Parliament relies, through to our better practice guides and benchmarking studies that add value to agencies' operations. While our approach needs to be monitored and reviewed for effectiveness over time, it should allow us to capitalise on our traditional strengths and to move into new value-adding areas in the future. We have pursued a focus on quality products as an essential element of our corporate planning which will assist us in meeting the objective of adding value to public administration.

Convergence of the public and private sectors

I would like to conclude with some final thoughts on convergence and its impacts on the ANAO's work. Convergence of the public and private sectors requires agencies to find the appropriate balance between efficiency and accountability with regard to their particular business opportunities and risks. Whether this will result in a different kind of accountability will largely be a decision of the Parliament and/or the Government.

As our public sector audit clients are renegotiating their activities within the changing governance landscape, so the ANAO is continuously refining its own processes and emphases to provide the optimal level of support to Parliament and to ensure that our relationship remains dynamic. In the coming years, the ANAO will continue to strengthen its assurance and advisory functions. We will continue to play an active role in the accounting and auditing profession. We will also continue to refine our strategic audit approach. We have some way to go, but we have identified a vision and we are working towards it. Change is inevitable. The challenge is to strategically position ourselves to respond to emerging circumstances by tailoring our products to continue to be relevant and to take advantage of opportunities for improvement and value adding as they arise.

Like our counterparts in the Australian States and overseas, we are engaged in identifying areas of risk, and opportunities for improvement, in setting our strategic agenda. Managing public sector businesses effectively in the international marketplace of the future will undoubtedly be challenging, with the increased emphasis on monitoring and reporting on intangible performance elements such as values, ethics, social and environmental responsibility. All public sector agencies, as well as the

ANAO, will need to continue to engage globally in identifying national approaches and solutions for greater effectiveness.

The emphasis will increasingly be on cooperation, sharing and communication as we now witness the move internationally to more 'joined up' government and the pressure for more citizen participation in the governance framework. Such developments have important implications for the public interest and accountability that need to be addressed, or at least understood, by Audit Offices. As in other areas of our responsibilities, we will be largely judged on our performance on such matters. Being passive is not an option. Being strategic and proactive is. The quality of the relationship between the Parliament and the ANAO will be vitally important for public sector accountability into the future, particularly as the public and private sectors converge. The ANAO's symbiotic relationship with the Parliament is crucial to its ability to respond strategically and tactically to change and to set its agenda for the future.

Meeting the challenges

I would like to conclude with some comments that I made in the ANAO's Annual Report for 2000-2001, our one hundredth year of auditing:

As we enter our second century of auditing, we must stay focussed on identifying and adapting to the ever-changing public sector environment. We have an ongoing commitment to the development of different audit practices and procedures in the face of new and emerging issues. We must continue to work to attract and retain staff with the right mix of skills and attributes. Fortunately, modern telecommunications has enabled us to deal with the tyranny of distance much more easily in meeting the challenge of auditing the activities of a Commonwealth spread across vast distances than was the case in the early days of Federation. To meet these and more recent challenges, we need to continually develop new and better strategies to deal successfully with such challenges. Our ability to do this will be enhanced if we can achieve an environment that is conducive to that result, including sustaining the professionalism and commitment of our staff and positive relationships with all our stakeholders, most notably the Parliament.⁹⁵

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