PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

SECOND REPORT TO PARLIAMENT

REPORT ON

THE PERFORMANCE AUDIT OF THE AUDITOR-GENERAL OF VICTORIA

NOVEMBER 1993

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Tuesday 10 November 1992

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE - The Honourable R.I. Knowles moved, by leave, That, contingent upon the Royal Assent being given to the Parliamentary Committees (Amendment) Bill, the Honourables P.R. Hall, T.C. Theophanous and D.R. White be members of the Public Accounts and Estimates Committees.

Question - put and resolved in the affirmative.

VOTES AND PROCEEDINGS OF THE LEGISLATIVE ASSEMBLY

Friday 13 November 1992

JOINT INVESTIGATORY COMMITTEES - Motion made, by leave, and question - That contingent on the coming into operation of the Parliamentary Committees (Amendment) Act 1992 -

Mr Baker, Mr Hyams, Mr Plowman (Bunambra), Mr Smith (Glen Waverley), Mr Thomson (Pascoe Vale) and Mr Weideman be members of the Public Accounts and Estimates Committee.

(Mr Cade) - put and agreed to.
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FUNCTIONS OF THE PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

The Public Accounts and Estimates Committee is constituted under the Parliamentary Committees Act 1968 as amended by the Parliamentary Committees (Joint Investigatory Committees) Act 1982, the Parliamentary Committees (Amendment) Act 1989 and the Parliamentary Committees (Amendment) Act 1992. It consists of nine members of Parliament drawn from the Legislative Council and the Legislative Assembly. The Committee carries out investigations and reports to Parliament on matters associated with the financial management of the State. Its functions under the Act are:

- to inquire into, consider and report to Parliament on any proposal, matter or thing connected with public administration or public sector finances if the Committee is required or permitted so to do by or under the Act;

- to inquire into, consider and report to Parliament on the annual estimates or receipts and payments and other Budget papers and any supplementary estimates of receipts or payments presented to the Assembly and the Council if the Committee is required or permitted so to do by or under the Act;

- to inquire into, consider and report to Parliament on any proposal, matter or thing relevant to the functions of the Committee by the resolution of the Council or the Assembly or by Order of the Governor in Council published in the government Gazette;

- it may inquire into, consider and report to Parliament on any annual report or other document relevant to the functions of the Committee which is laid before either House of the Parliament pursuant to a requirement imposed by or under an Act.
PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

CHAIRMAN'S INTRODUCTION

In 1992, the first performance audit of the Victorian Auditor-General’s Office was undertaken by Mr Fergus Ryan of Arthur Anderson. Mr Ryan was required to assess the Auditor-General's performance, having regard to internationally established best practice, and to recommend actions for improvements.

Overall audit conclusions were very favourable. Mr Ryan concluded that the Auditor-General is meeting his objectives effectively, economically and efficiently and that the direction and momentum of the Audit Office are positive and constructive. This represents a substantial achievement for any Audit Office and on behalf of the Committee, I congratulate the Auditor-General and his staff on this achievement. The findings of this Inquiry provide further support to Mr Ryan's overall conclusions.

A number of recommendations and suggestions were made by Mr Ryan to further improve accountability and encourage optimal use of public resources. It was acknowledged that the implementation of these recommendations would require responses not only from the Auditor-General but also from the Parliament and the Executive.

The Committee has considered the issues raised by Mr Ryan, in his Report, along with a number of related issues which are considered, by the Members, to be of significance to the audit process within the public sector. Some of the Committee’s main findings include:

- there is considerable opportunity to enhance the management of the public sector if the Auditor-General concentrates his audit resources in those areas which represent the greatest risk and/or are the most significant to the public sector as a whole. This will involve the regular review and assessment of the critical processes within the central agencies.
• there is an opportunity to facilitate the Auditor-General’s ability to meet the needs of the Parliament by ensuring that a bi-partisan Parliamentary committee, rather than the executive, is responsible for reviewing the Audit Office’s budget and making a recommendation on this to the Parliament.

• there is scope for improving public accountability by broadening the Auditor-General’s audit mandate.

I thank the Members of the Committee for their contributions, and on behalf of the Committee, I thank the organisations and individuals who contributed to the Inquiry through oral and written presentations.

I also thank the staff of the Committee. The report was drafted by Mr Craig Burke, Director of Research and Mrs Dianne Agis, Research Officer. Mrs Helena Cyrulo provided administrative support. I would also like to acknowledge the work of the Committee’s former Director of Research, Mrs Victoria Walker who assisted the Committee during the early stages of the Inquiry.

Finally, I thank the staff from the Joint Committee Office Administration for their efficient word processing under very tight deadlines.

Hon. G. Graeme Weideman, MP, JP
Chairman
Public Accounts and Estimates Committee
REPORT ON THE PERFORMANCE AUDIT OF THE AUDITOR-GENERAL OF VICTORIA

EXECUTIVE SUMMARY OF MAJOR FINDINGS AND CONCLUSIONS

Overview

- The findings of this Inquiry support the overall conclusions reached by Mr Ryan as a result of his 1992 performance audit of the Auditor-General's Office, that the Auditor-General is meeting his objectives effectively, economically and efficiently and that the direction and momentum of the Audit Office are positive and constructive.

Risk Assessment

- The Auditor-General is best placed to assess the adequacy of risk management within the central agencies given his legislative responsibilities and the collective knowledge of the Victorian public sector within the Audit Office.

- There is considerable opportunity to enhance the management of the public sector if the Auditor-General concentrates his audit resources in those areas which represent the greatest risk and/or are the most significant to the public sector as a whole. This will involve regular review and assessment of the critical processes within the central agencies.

- The Public Accounts and Estimates Committee, as the primary contact between the Auditor-General and the Parliament, should contribute to the Auditor-General's assessment of risk within the public sector. Accordingly, the Committee should be given the opportunity to discuss the Auditor-General's performance audit plan with him, on an annual basis, and to suggest possible performance audits subjects.

- In order to evaluate risk within the public sector, the Auditor-General's officers must have unrestricted access to all information held within the central agencies. Where information is withheld, the Auditor-General should utilise the powers provided under section 44 of the Audit Act 1958, to obtain the information which he deems necessary to the conduct of audits.
Entities Not Subject to Audit by the Auditor-General

- The operation of the State Owned Enterprises Act 1992 may remove public sector entities from the audit mandate of the Auditor-General.

- Where audits of public sector entities are undertaken by private sector firms, rather than by the Auditor-General, there is a reduction in public accountability.

- There is a greater need for accountability in the public sector than in the private sector because taxpayers, unlike shareholders, cannot withdraw their funds and have a right to assurance that funds provided by way of taxes and charges are spent in accordance with legislation and that services provided by government reflect value for money.

- Given the substantial investment of public sector funds in Victoria's government business enterprises, together with the significant social and economic impact of those entities, it is considered appropriate that the Auditor-General retains responsibility for the financial and performance audits of all government business enterprises irrespective of their legal form.

- It is undesirable that government entities, through the establishment of companies, trusts and other arrangements, have the ability to divert public resources into entities with the result that public accountability in relation to those resources is reduced. Legislation should therefore require that the Auditor-General audits all entities in which the State has a controlling interest.

- The public accountability process is not only important in cases where State monies are directly involved in a venture, it is also important where the State acquires a financial risk in respect of certain private sector activities through the issue of government guarantees, indemnities and other undertakings. Where these undertakings expose the public sector to a significant risk, the contractual terms and conditions should include a requirement that the Auditor-General be the approved auditor, or at a minimum, have access to the accounts and records of the private sector entity.
Appointment of the Auditor-General

- The appointment of the Auditor-General on the recommendation of the executive is inconsistent with the Auditor-General’s role in ensuring the accountability of the executive to the Parliament.

- A Parliamentary committee should have responsibility for making a recommendation to the Parliament concerning the appointment of the Auditor-General. The Public Accounts and Estimates Committee’s knowledge and understanding of the Auditor-General’s role ensures that it is well placed to undertake this responsibility.

Funding of the Audit Office

- A Parliamentary committee, with due recognition of the Government’s overall budgetary strategies, should be responsible for reviewing the Audit Office’s budget proposals and making a recommendation to the Parliament.

- In order to ensure that the Auditor-General retains his independence, the proposed committee’s role in setting the Auditor-General’s budget should, in no way, impact upon the Auditor-General’s ability to determine the application of audit resources or lead to a review of the merits or otherwise, of particular performance audit proposals. Performance audits should therefore be funded on a total, annual basis rather than on an individual basis.

- Given that the Parliament is the Auditor-General’s client, it is considered appropriate that all performance audits be funded directly by the Parliament.

Objectives of the Audit Office

- The Audit Office’s objectives should be reviewed annually by the Auditor-General and the Public Accounts and Estimates Committee.
GLOSSARY OF TERMS

Accountability
The obligation assumed by those who exercise authority to account for the manner in which they have discharged the responsibilities entrusted to them.

Auditee
An organisation or individual subject to audit.

Auditing
A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (Committee on Basic Auditing Concepts, A Statement of Basic Auditing Concepts, American Accounting Association, 1973, p. 2)

Audit mandate
A specification of what is required of an auditor which provides the authority to carry out the work and to report. This is usually expressed in legislation.

Budget Estimates
Incorporates estimates of all budget sector receipts and payments, together with information about the activities and outputs which those financial transactions support.

Budget sector
Encompasses activities funded primarily by State taxation, Commonwealth grants and dividends payable by public authorities in the non-budget sector. The budget sector includes the Public Account and those public bodies outside the Public Account that are subject to central budgetary controls (Treasurer of the State of Victoria, Budget Strategy and Review 1993/94, Budget Paper No. 2, p. 3.3)

Community service obligations
Services provided by government business enterprises at the direction of the Government which the enterprises would not elect to provide on a commercial basis, or which would only be provided commercially at a higher price.

Consolidated Fund
The account into which the Victorian government’s revenue is paid (unless specifically provided otherwise) and from which monies are appropriated by the Parliament for government purposes.

Contingent liability
A potential commitment, the occurrence of which is dependent upon future events or outcomes.
Corporatisation
A process which attempts to establish a structure of incentives for government business enterprises which approximate those of private sector firms with the aim of providing the enterprises with a more commercial focus.

Economy
The acquisition of the appropriate quality and quantity of financial, human and physical resources at the appropriate times and at the lowest possible cost (Statement of Auditing Practice, AUP 33, Performance Auditing, para. 6)

Effectiveness
The achievement of the objectives or other intended effects of programs, operations or activities (Statement of Auditing Practice, AUP 33, Performance Auditing, para. 6)

Efficiency
The use of financial, human and physical resources such that output is maximised for any given set of resource inputs, or input is minimised for any given quantity and quality of output (Statement of Auditing Practice, AUP 33, Performance Auditing, para. 6)

Financial audit
An examination of financial information for the purpose of attestation, being the expression of an opinion on the financial statements to help establish the validity of those statements (Introductory Statement on Applicability of Statements of Auditing Standards and Statements of Auditing Practice to Auditing in the Public Sector, para. 5)

Government business enterprises (GBEs)
Publicly owned entities which provide goods or services on commercial terms. These entities aim to recover their production costs through direct user charges and in most cases also aim to provide some financial return to the government.

Materiality
Refers to the extent of mis-statement (including an omission or non-disclosure) of relevant and reliable financial information either individually or in aggregate that, in the light of surrounding circumstances, makes it probable that the judgement of the users of that information would be influenced by the mis-statement when making and evaluating decisions on the allocation of scarce resources (Statement of Auditing Practice, AUP 27, Materiality and Audit Risk)

Non-budget sector
Contains State authorities which operate on a commercial basis with, as a general rule, at least 50 per cent of their revenue obtained from usage charges (Treasurer of the State of Victoria, Budget Strategy and Review 1993/94, Budget Paper No. 2, p. 3.3)
Performance audit
An examination of financial information and other records for the purpose of reporting on the controls, processes and systems used to manage the entity's resources, money, people, physical assets and information, and in many cases to make comment on the entity's operations in terms of the economy in acquiring resources, efficiency in using resources and effectiveness in achieving objectives (Introductory Statement on Applicability of Statements of Auditing Standards and Statements of Auditing Practice to Auditing in the Public Sector, para. 5)

Privatisation
The transfer, by sale or other means, of assets or operations from the public sector to the private sector

State Owned Enterprise
A government business enterprise which has been declared by Order in Council to be a State body, State business corporation or State owned company under the provisions of the State Owned Enterprises Act 1992.

Working papers
The records kept by the auditor of the procedures followed, tests performed, information obtained and conclusions reached pertinent to the audit.
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<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>EDP</td>
<td>Electronic Data Processing</td>
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<tr>
<td>EFAM</td>
<td>Enhanced financial audit methodology (this methodology is utilised by the Victorian Audit Office)</td>
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<tr>
<td>JCPA</td>
<td>Joint Committee of Public Accounts (Commonwealth Parliamentary committee)</td>
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<tr>
<td>GBE</td>
<td>Government business enterprise</td>
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<tr>
<td>OPSM</td>
<td>Office of Public Sector Management (within the Department of the Premier and Cabinet)</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>VMO</td>
<td>Visiting medical officer</td>
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<tr>
<td>VPAM</td>
<td>Victorian performance audit methodology (this methodology is utilised by the Victorian Audit Office)</td>
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FINDINGS AND RECOMMENDATIONS

Finding 3.1 (Page 23)

The primary responsibility for risk identification and management within the public sector rests not with the Auditor-General, but with the central agencies.

Finding 3.2 (Page 25)

The Auditor-General is best placed to assess the adequacy of the risk management processes within the central agencies.

Finding 3.3 (Page 25)

The Auditor-General is responsible for evaluating the procedures (or controls) which the managers of central agencies have put in place to enable them to identify and manage risks. If those controls do not exist or are inadequate, the Auditor-General has a responsibility to report any deficiencies to the Parliament and/or management, as appropriate, so that action may be taken to rectify existing weaknesses.

Recommendation 3.1 (Page 26)

The Auditor-General, in accordance with the recommendations outlined in Mr Fergus Ryan’s Report on the performance audit of the Auditor-General, should review the critical objectives of the central agencies each year in order to determine whether the agencies are achieving those objectives.
Recommendation 3.2 (Page 26)

In conducting performance audits of the central agencies, the Auditor-General should utilise external consultants and experts, where he believes this to be appropriate, in order to supplement and complement the existing skill base within the Audit Office.

Finding 3.4 (Page 27)

Early audit review of risk identification and management processes within the central agencies is likely to increase the overall benefits derived from central agency audits and remains a priority given the State's potential risks.

Recommendation 3.3 (Page 27)

Review of risk identification and management processes within the central agencies should be undertaken by the Auditor-General as soon as practicable and should not be deferred until the processes within the central agencies have been fully developed and implemented.

Finding 3.5 (Page 28)

Under recent legislative and administrative reforms within the Victorian public sector, the central agencies continue to have a major role in ensuring that public sector entities utilise resources efficiently and effectively and in accordance with prevailing policies and practices. The need for the Auditor-General to review central agency risk management processes therefore remains significant to the State.

Finding 3.6 (Page 31)

The Public Accounts and Estimates Committee, as the primary contact between the Auditor-General and the Parliament, should contribute to the Auditor-General's assessment of risk within the public sector.
Recommendation 3.4 (Page 31)

The Auditor-General should provide a copy of his performance audit plan to the Public Accounts and Estimates Committee on an annual basis and the Committee given the opportunity to discuss this plan with the Auditor-General and suggest but not dictate subjects for performance audits.

Finding 3.7 (Page 31)

In order to clarify and enhance the relationship between the Public Accounts and Estimates Committee and the Auditor-General, the guidelines on the working relationship between the 2 parties will be revised to incorporate the Committee’s role in the assessment of risk and other relevant matters. Input on revised guidelines and acceptance of completed guidelines will be obtained from both the Committee and the Auditor-General.

Finding 3.8 (Page 34)

The Auditor-General has been hampered in proceeding with the risk assessments of central agencies due to lack of information forthcoming from 2 of the 3 agencies. On past occasions, the Auditor-General has also reported to the Parliament that his officers have been refused access to information.

Finding 3.9 (Page 34)

In order to evaluate risk within the public sector, the Auditor-General’s officers must have unrestricted access to all information held within the central agencies. Accordingly, the withholding of information by auditees is a significant problem which needs to be addressed.
Recommendation 3.5 (Page 35)

The Auditor-General should utilise his powers under the Audit Act 1958 to obtain required information from those agencies who fail to supply that information at the Auditor-General’s request.

Recommendation 3.6 (Page 35)

The Auditor-General should report any problems encountered in obtaining information from auditees to the Parliament and/or the Public Accounts and Estimates Committee, as appropriate.

Recommendation 3.7 (Page 35)

Utilisation of powers provided under section 44 of the Audit Act 1958 should be reported to the Parliament, by the Auditor-General, along with details of the outcome of this course of action.

Finding 3.10 (Page 38)

The roles and responsibilities of the Office of Public Sector Management within the Department of the Premier and Cabinet and the Office of State Owned Enterprises within the Department of Treasury complement, rather than substitute for, the roles and responsibilities of the Auditor-General.

Recommendation 3.8 (Page 38)

The Auditor-General should have access to all documentation, including strategies and work programs, associated with the special investigations and performance reviews undertaken by:

- the Office of Public Sector Management within the Department of the Premier and Cabinet; and
• the Office of State Owned Enterprises within the Department of Treasury.

These reviews should be assessed and where appropriate, utilised to reduce detailed work undertaken by Audit Office staff at the various government departments and authorities.

Finding 4.1 (Page 50)

The Auditor-General is responsible for informing the community, through the Parliament, about the probity and quality of the Government’s stewardship of public resources. Given the substantial investment of public sector funds in Victoria’s government business enterprises together with the significant economic and social impact of these entities, the Auditor-General should retain responsibility for the financial and performance audits of government business enterprises irrespective of their legal form.

Recommendation 4.1 (Page 50)

The legislative mandate for financial and performance audits by the Auditor-General should be broadened to ensure that it captures all government business enterprises including the various forms of State owned enterprises as part of the current legislative reforms.

Recommendation 4.2 (Page 53)

Legislation should require that the Auditor-General audits all entities (including trusts, joint ventures, partnerships, companies and other entities) in which the State has a controlling interest.
Finding 4.2 (Page 57)

When the public sector acquires a minority interest in an entity, it has a responsibility to ensure that there are adequate processes in place to monitor and safeguard its interest in that entity. The significance of the State's exposure will determine the nature and extent of those processes. As indicated by the collapse of the Tricontinental Group of Companies, State monitoring mechanisms will not necessarily ensure that all problems, within the entity, are identified.

Recommendation 4.3 (Page 57)

The Auditor-General should review and evaluate the adequacy of the processes that the central or other agencies put in place to monitor and safeguard minority public sector holdings in private sector entities.

Finding 4.3 (Page 59)

The public accountability process is not only important in cases where State monies are directly involved in a venture, it is also important where the State acquires a financial risk in respect of certain private sector activities through the issue of government guarantees, indemnities or other undertakings.

Finding 4.4 (Page 60)

Where the public sector has a financial risk in relation to the activities of an entity in which the State has no equity interest:

a) it is incumbent upon the public sector to ensure that it has adequate procedures in place to monitor its exposure; and

b) the Auditor-General should review and evaluate the adequacy of the processes that the central or other government agencies have put in place to monitor this risk.
Recommendation 4.4 (Page 60)

Where the public sector bears a significant risk in respect of the activities of an entity which is wholly owned by the private sector, the terms and conditions of the arrangement should include a requirement that the Auditor-General be the appointed auditor, or at a minimum, have access to the accounts and records of the private sector entity.

Finding 5.1 (Page 64)

The appointment of the Auditor-General, on the recommendation of an executive, is inconsistent with the Auditor-General’s role in ensuring the accountability of the executive to the Parliament.

Finding 5.2 (Page 64)

The Public Accounts and Estimates Committee’s knowledge and understanding of the Auditor-General’s role ensures that the Committee is well placed to undertake the duties associated with the selection of an Auditor-General.

Recommendation 5.1 (Page 64)

The Public Accounts and Estimates Committee (or its successor) should be responsible for making a recommendation to the Parliament concerning the appointment of the Auditor-General.

Recommendation 5.2 (Page 64)

The Auditor-General should be appointed by the Governor in Council on the nomination of the Parliament.
Finding 5.3 (Page 69)

A Parliamentary committee, with due recognition of the Government's overall budgetary strategies, should have a role in determining the Audit Office's budget.

Finding 5.4 (Page 69)

Review of the Audit Office's budget by the Public Accounts and Estimates Committee, would be incompatible with some of the Committee's other activities, including its role in scrutinising the Annual Budget Estimates, reviewing the Audit Office's output and recommending possible performance audit subjects.

Recommendation 5.3 (Page 70)

It is recommended that:

(a) a seven member Parliamentary committee be established to review the Audit Office's budget proposals and make a recommendation to the Parliament;

(b) this committee should comprise the Speaker of the Legislative Assembly or President of the Legislative Council who should alternate on an annual basis;

(c) the composition of the remainder of the committee should ensure an equal representation of Government and Opposition members and should include the Treasurer (or his Parliamentary representative) and the Chairman and one other member of the Public Accounts and Estimates Committee; and

(d) the Speaker and President should alternate as Chairperson on an annual basis.
Recommendation 5.4 (Page 70)

The proposed committee's role in setting the Auditor-General's budget should, in no way, impact upon the Auditor-General's ability to determine the application of audit resources or lead to a review of the merit, or otherwise, of particular performance audit proposals. Performance audits should therefore be funded on a total, annual basis rather than on an individual basis.

Recommendation 5.5 (Page 71)

The Audit Office's objectives should be reviewed jointly by the Public Accounts and Estimates Committee and the Auditor-General, on an annual basis.

Recommendation 5.6 (Page 71)

The Committee should endorse the adoption, by the Audit Office, of the agreed objectives.

Recommendation 5.7 (Page 72)

The Audit Office should include the endorsed objectives in its annual report so that Parliament is informed of those objectives.

Finding 6.1 (Page 76)

The auditor who is selected to undertake the next performance audit of the Audit Office will be directed by the Committee to follow up each of the matters raised by Mr Ryan, in respect of financial audits, in order to ensure that all issues have been satisfactorily resolved.
Finding 6.2 (Page 77)

The Committee will monitor, on an ongoing basis, the progress made by the Auditor-General in resolving auditee concerns on the timing of financial audits.

Finding 7.1 (Page 81)

The Committee concurs with Mr Ryan’s opinion that notification of potential performance audits, by the Audit Office, might result in earlier realisation of benefits.

Finding 7.2 (Page 81)

In order to ensure that action taken by auditees to improve existing systems is concentrated on critical operational areas, auditees should be advised of a manageable number of significant potential performance audit subjects from the Audit Office’s Master Audit Plan.

Recommendation 7.1 (Page 81)

Where appropriate, auditees should be advised, on an annual basis, of those potential performance audits which, in the Auditor-General’s view, are likely to provide significant benefits and/or cost savings given prevailing conditions.

Finding 7.3 (Page 86)

The Committee supports Mr Ryan’s view that performance audit reports should, wherever possible, include recommendations for correction or prevention of problems, and will monitor the progress made by the Audit Office, in this regard.
Finding 8.1 (Page 91)

The Committee believes that for the most part, financial audit fees, charged by the Audit Office, should reflect value for money given that:

- the Office sets its fees in accordance with Department of Treasury guidelines and aims only to recover its costs;
- Mr Fergus Ryan concluded that the Auditor-General is meeting his objectives effectively, economically and efficiently; and
- the Audit Office is subject to triennial performance audits.

Recommendation 8.1 (Page 92)

Given that the Parliament is the Auditor-General's client, it is recommended that performance audits be funded by the Parliament rather than by auditees.

Recommendation 8.2 (Page 93)

The Committee concurs with Mr Ryan's finding that unnecessary delays in issuing audit reports is not conducive to the prompt resolution of problems identified by audit. Accordingly, it is recommended that the Auditor-General take action to rectify this matter.

Finding 9.1 (Page 96)

The Committee concurs with Mr Ryan's finding that the pooling of staff, within the Audit Office, could provide benefits to auditees as well as to the Audit Office and its staff. The Committee will continue to monitor the status of this matter.
Recommendation 9.1 (Page 96)

It is recommended that the Audit Office, in accordance with Mr Ryan's recommendation, pool all staff below Director of Audit level across the divisions reporting to a Chief Director of Audit.

Finding 9.2 (Page 97)

In view of pending legislative changes and the need for a full and detailed assessment of all possible implications, the Committee will undertake, at a later date, a separate inquiry into whether or not the Audit Office should become a statutory authority.

Finding 10.1 (Page 99)

The contractual terms and conditions relating to the appointment of an auditor to undertake the performance audit of the Audit Office, will in future, include an expressed requirement that the auditor's working papers are to be made available to the next auditor.
CHAPTER ONE: INTRODUCTION AND BACKGROUND TO THE COMMITTEE'S INQUIRY

1.1 BACKGROUND

1.1.1 Legislative Requirements

The Audit Act 1958, as amended in June 1990, requires that a performance audit of the Auditor-General of Victoria be conducted at least once every 3 years. Under the Act, the former Economic and Budget Review Committee is responsible for recommending an auditor to conduct the performance audit of the Auditor-General.

Section 48B of the Audit Act 1958 states, in part, that:

1. An audit shall be conducted under this section at least once every three years to determine whether the Auditor-General is achieving his or her objectives and doing so economically and efficiently and in compliance with the Act.

2. An audit under this section shall be conducted by an auditor appointed by resolution of the Council and the Assembly, on the recommendation of the Economic and Budget Review Committee of the Parliament.

3. An auditor appointed under this section -

   a. shall be appointed on such terms and conditions and is entitled to such remuneration as are determined by the Economic and Budget Review Committee; and

   b. in conducting the audit, must comply with directions as to the audit given by that Committee.

Section 48B of the Audit Act 1958 is attached at Appendix A.

1.1.2 Selection of Auditor

Pursuant to the Audit Act 1958, the former Economic and Budget Review Committee, in December 1991, invited major accounting firms to submit proposals
for the performance audit of the Audit Office. Six proposals were received in February 1992. All proposals were subsequently explored by way of interview.

In seeking to appoint the auditor, the former Committee considered the following selection criteria. That the auditor:

- be a member of a leading firm in the field of auditing and consulting and hold a prominent and respected position in the profession;

- have an appreciation of the role of the Auditor-General;

- have knowledge and experience in the use of modern audit methodologies and techniques;

- have knowledge and experience in the application of large scale audit project methodologies;

- have a general knowledge and understanding of the nature of public sector organisations and the Victorian Government’s system of financial administration;

- have the ability to allocate sufficiently skilled and experienced staff to undertake the performance audit of the Auditor-General; and

- not be involved personally during the course of the audit with an audit examination or consultancy in a department or agency in respect of which the Auditor-General has a statutory responsibility so as to avoid a possible conflict of interest with the performance of the audit function.

In appointing an auditor the former Committee wished to make an appointment of an individual who was prepared to have a substantial individual input to the audit.

The former Economic and Budget Review Committee recommended to the Council and the Assembly that Mr Fergus Ryan from Arthur Andersen be appointed as the auditor to conduct the performance audit of the Auditor-General. The appointment was formally approved by the Parliament in March 1992.
1.1.3 The Committee's Directions to the Auditor

The Audit Act 1958 does not specifically state that the performance audit of the Auditor-General should determine whether the Auditor-General is meeting his objectives effectively under the Act, while the mandate for the Auditor-General to undertake performance audits specifically includes determining whether a department or public authority is achieving its objectives effectively. As the Act was designed to ensure that performance audits of the Auditor-General are undertaken in a similar manner to those undertaken by the Auditor-General of a department or public authority, the former Committee directed the auditor to examine whether the Auditor-General was meeting his objectives effectively as well as doing so economically and efficiently.

Directions

The former Committee gave the following directions for the conduct of the audit:

The auditor should determine whether the Auditor-General is achieving his objectives effectively and doing so economically and efficiently and in compliance with the Act.

The performance audit should:

- survey a sample of users of the Auditor-General's Reports to the Parliament (members of Parliament, representatives of the Executive Government and selected others) to determine whether the Auditor-General is meeting his objectives in this area;

- survey a sample of auditees to examine the Auditor-General's ability and willingness to apply appropriate resources to meet their needs;

- review the audit methodologies used by the Auditor-General in relation to the use of resources and the meeting of audit requirements including a review of engagements in both the areas of financial and performance audit; and

- review the overall management of resources within the Office of the Auditor-General.
In conducting the audit the auditor will have regard to internationally established best practices in assessing the performance and recommending actions for improving the performance of the Auditor-General.

Timing of the report

The auditor was required to make the report by 15 September 1992 or such later date as the Committee directed and within seven sitting days after making the report transmit the report to the Legislative Assembly.

Mr Fergus Ryan's Report on the performance audit of the Auditor-General was forwarded to the Presiding Officers of Parliament in August 1992 and was tabled on 27 October 1992.

Remuneration for the performance audit

The Committee determined that the remuneration for the performance audit would be $200,000. This was the amount actually paid for the audit services provided.

1.2 THE COMMITTEE'S INQUIRY

1.2.1 Terms of Reference

In accordance with the Parliamentary Committees Act 1968, the Public Accounts and Estimates Committee conducted an Inquiry with the following terms of reference:

- to inquire into, consider and report to the Parliament on Mr Fergus Ryan's 'Report on Performance Audit of the Auditor-General of Victoria Pursuant to Section 48B of the Audit Act 1958';

- an examination of whether the Auditor-General is achieving his objectives effectively and doing so economically and efficiently and in compliance with the Act;

- an examination of action taken or proposed by the Auditor-General in response to Mr Fergus Ryan's Report;
an assessment of the auditor's compliance with the former Committee's directions in conducting the performance audit of the Audit Office; and

- an assessment of the establishment and conduct of the audit with a view to enhancing future performance audits of the Audit Office.

1.2.2 Method of Investigation

The Public Accounts and Estimates Committee inquired into the key issues identified by Mr Fergus Ryan in his performance audit of the Auditor-General through:

- seeking written and oral submissions;

- examination of submissions received from auditees and other relevant interested parties;

- consideration of key issues at several public hearings;

- formal and informal discussions with the Auditor-General, Mr Fergus Ryan and other relevant parties; and

- analysis of reports prepared by other Parliamentary Committees as a result of their inquiries into the functions and performance of Auditors-General elsewhere in Australia as well as overseas.

The Committee would like to acknowledge the co-operation and assistance received from the Auditor-General, Mr C. Baragwanath and his senior staff and from Mr Fergus Ryan.

1.3 KEY FINDINGS AND RECOMMENDATIONS OF THE FERGUS RYAN REPORT ON THE PERFORMANCE AUDIT OF THE AUDITOR-GENERAL

In forwarding his Report to the Presiding Officers of Parliament, Mr Ryan in an accompanying letter, acknowledged the attitude of complete co-operation and openness which he had received from the Auditor-General and Audit Office staff
during the engagement. Mr Ryan also stated that the implementation of his recommendations for enhancing the effectiveness of the Auditor-General would require responses not only from the Auditor-General but also from the Parliament and the Executive.

The Auditor-General indicated in a letter of response to the Report that he had already initiated action to implement a number of Mr Ryan's suggestions and acknowledged that the recommendations contained in the Report should enhance the effectiveness of the Audit Office.

Overall opinion

Mr Fergus Ryan concluded that the Auditor-General is meeting his objectives effectively, economically and efficiently.\(^1\) He also concluded that the direction and momentum of the Auditor-General's Office are positive and constructive.\(^2\) Mr Ryan made a number of recommendations and suggestions to further improve accountability and encourage economic, efficient and effective use of public resources. In making these recommendations, Mr Ryan acknowledged that the Audit Office is currently in a period of transition with amendments to the Audit Act in 1990 which formalised and expanded the performance audit mandate and the recent introduction of new financial and performance audit methodologies within the Audit Office.\(^3\)

Other major findings and recommendations as contained in the 'Report on Performance Audit of the Auditor-General of Victoria Pursuant to Section 48B of the Audit Act 1958' are summarised as follows:

Risk assessment

The central agencies comprise the Department of Treasury, the Department of Premier and Cabinet and the Ministry of Finance. Those agencies have some risk assessment and control responsibilities which extend across the public sector as a whole and therefore significantly affect the Auditor-General’s auditee base. The responsibilities of the central agencies include the development of policies and strategies aimed at maximising financial and resource management, assessing the

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2 Ibid.
3 Ibid., page 2.
efficiency and effectiveness of government programs and advising on, and/or monitoring the financial aspects of major infrastructure proposals, debt management, accounting and audit policies, information technology, budgetary policies, revenue raising strategies and other matters.

Mr Ryan recommended that the Auditor-General should firstly assess how effectively the central agencies are fulfilling these responsibilities before planning the audits of specific auditees. It was suggested that this approach would better enable the Auditor-General to contribute to the prevention of problems rather than their identification.⁴

Appointment of the Auditor-General

The Auditor-General should be appointed on the nomination of the Parliament and not the executive.⁵

Funding of the Office

The budget of the Audit Office should be approved by Parliament through a specific appropriation rather than subject to review by the executive.⁶

Relationship with Parliament

Parliament should be responsible for endorsing the Audit Office’s Corporate Plan and should also review the annual performance audit plan. Parliament should recommend, but not require subjects for performance audits. Such communication will help ensure that the Auditor-General is meeting the needs and expectations of Parliament and will potentially contribute to the overall effectiveness of the Auditor-General.⁷

Financial audits

Mr Fergus Ryan concluded that the Office’s financial audit methodology is consistent with current audit thinking and complies with Australian auditing

⁴ Ibid.
⁵ Ibid., page 13.
⁶ Ibid., page 15.
⁷ Ibid., page 3.
standards. He recommended that planning for financial audits commence far earlier in the financial year. It was also suggested that some specific aspects of the execution of financial audits could be improved. These are:

- use of sampling techniques;
- determination and documentation of audit scopes and materiality levels;
- integration of EDP risk evaluation into the audit process;
- clearer identification of the linkages between risk evaluation and audit approach;
- enhanced post-balance date review processes; and
- more actively seeking out opportunities to make use of internal audit work.

**Performance audits**

It was found that the Office’s performance audit methodology is advanced in development by world standards and its application to specific engagements is generally of a high standard. Recommendations for further improvement included:

- performing more audits of subjects such as labour costs and information technology which are relevant to a number of auditees;
- notifying auditee management of potential audit subjects;
- selecting some audits in the expectation of identifying best practices;
- developing an improved style of executive summary in audit reports in order to convey the audit objectives, scope, conclusions and recommendations in a more balanced manner;

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8 Ibid.
9 Ibid., pages 3-4.
10 Ibid., page 4.
11 Ibid.
developing recommendations to either address identified problems or prevent their recurrence;

enhancing communications with auditees during the report writing process;

the instigation of a peer review process; and

continued broadening of the skill base of performance auditors.

**Relationship with auditees**

It was found that while the Auditor-General’s relationship with Parliament is generally effective, auditee relationships could be improved. Recommendations for improving relationships with auditees included:

- applying the same client service orientation to auditees as is applied to Parliament;

- funding of performance audits by Parliament rather than charging auditees;

- negotiation of annual financial audit fees and fee overruns with auditees; and

- advising auditees promptly and in writing of significant issues.

**Office management**

It was found that the practices of the Office in matters of resource management, professional training and development and use of information technology are sound and are comparable to those employed by private sector audit firms of similar size. In particular, it was noted that senior management had taken a pro-active role in ensuring the adequacy of strategic planning and development processes. Suggestions for further improving Office management included:

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12 Ibid., page 47.
13 Ibid., page 5.
14 Ibid., page 6.
15 Ibid.
• restructuring of current divisional arrangements within the Audit Office so that staff below Director of Audit level are pooled across divisions;

• establishment of the Auditor-General’s Office as a statutory authority, however the consequences of such a change need to be first evaluated; and

• continued incremental annual increases in staff available for performance audits.

Summary 1.1

Mr Fergus Ryan in his Report on the performance audit of the Auditor-General concluded that:

• the Auditor-General is meeting his objectives effectively, economically and efficiently; and

• the direction and momentum of the Auditor-General’s Office are positive and constructive.

Mr Ryan, having acknowledged that the Audit Office is currently in a period of transition, made a number of suggestions and recommendations to further improve accountability and encourage economic, efficient and effective use of public resources.
CHAPTER TWO: OVERVIEW OF THE OFFICE OF THE AUDITOR-GENERAL

2.1 BACKGROUND

Under the Westminster system, the Auditor-General is responsible, under Statute, for the external audit of the financial affairs of the Victorian public sector and reports directly to the Parliament.

The Auditor-General is appointed, on the recommendation of the Premier, by the Governor in Council. Once appointed, the Auditor-General has statutory tenure until the age of 65 and can only be removed by resolution of both Houses of Parliament. The Auditor-General is an officer of the Crown and is not subject to direction by the Government.

Traditionally, the scope of the Auditor-General’s audits was limited to compliance and financial (attest) matters. A financial audit can broadly be defined as an examination of financial information for the purpose of expressing an opinion on the fair presentation of a set of financial statements.

In recent years, there has been an expansion of audit scope to performance audits. A performance audit entails an examination of financial and other records for the purpose of evaluating whether an organisation uses its resources economically and efficiently in order to effectively meet its objectives.

Both performance and financial audits may include an assessment of auditee compliance with statutory requirements, regulations, rules, ordinances or directives that govern the activities of the entity.

2.2 LEGISLATION

The Audit Act 1958 is the principal legislation relating to the appointment, tenure, duties, responsibilities and powers of the Auditor-General. In 1990, the Audit (Amendment) Act was passed. This clarified and strengthened the Auditor-General’s role by providing him with an expressed mandate to conduct performance audits.
Under the *Audit Act* 1958, the Auditor-General is required to

- undertake annual audits of the accounts of public authorities and departments and prepare reports of the results of these audits (sections 31 and 32); and


In addition, under section 48A of the *Audit Act* 1958, the Auditor-General may conduct any audit, as he thinks fit, to determine if a department or public authority is achieving its objectives effectively and doing so economically and efficiently and in compliance with all relevant Acts. The Auditor-General, in conducting performance audits is not entitled to question the merits of Government policy objectives.

The majority of the work performed by the Audit Office is conducted under the authority of the *Annual Reporting Act* 1983. This Act was adopted to improve the accountability of the executive to the Parliament and is supplemented by the various enabling Acts establishing public bodies.

### 2.3 ROLE AND OBJECTIVES

#### 2.3.1 Role

One of the characteristics of public sector external auditing is that the objectives and scope of the audit are often broader than those of private sector audits. This is directly related to the fact that public sector organisations are responsible to the public, through their elected representatives. The role of the Auditor-General is to facilitate that accountability by providing impartial and objective reports on the stewardship and performance of officials. The importance of the disclosure and accountability process is fundamental to the Westminster system of Government. In meeting his accountability responsibilities, the Auditor-General needs to ensure that the auditee has substantially complied with its obligations in all aspects of financial operations and has not exceeded its legislative powers.
The following statement was included in the Audit Office's 1992 Annual Report and provides an insight into the Auditor-General's views on accountability:

"In this era of open government, a concept which is largely accepted by all political parties, I believe it is necessary that light - full light - be shed upon the manner in which taxes, which impose heavy sacrifices upon every citizen, are used. Full light is the prerequisite of good order" (C.A. Baragwanath. Victorian Auditor-General)

The primary objective of private sector entities is normally to return a profit while the objectives of Government are often more complex. An audit of the financial statements of a public sector organisation may not adequately provide information on how well the entity has met its objectives. Accordingly, the scope of the public sector external audit has been extended beyond the traditional financial (attest) audit to examine whether an organisation is meeting its objectives and doing so in a manner which ensures the most efficient use of the public resources available to it.

2.3.2 Mission and Corporate Objectives

The Audit Office's mission is:

To independently assess the operations of the Victorian public sector and report the results of the assessment to the Parliament and the public, the Government and auditees in order to improve accountability and encourage economic, efficient and effective use of public resources.¹

The Office's Corporate Plan identifies 4 strategic directions which are intended to guide the Office's operations over the 3 year period July 1991 to June 1994. These strategic directions are:

1. Expand performance auditing conducted and reported by the Office to fulfil the widened legislative mandate.

2. Maximise the productivity of current resources undertaking financial audits through the application of the most advanced audit methodologies.

3. Widen opportunities for staff to contribute to Office achievements by upgrading the workforce management plan to improve the development and deployment of staff.

4. Ensure that Office activities are driven by value-added and risk-based management concepts and benefit from developments in information technology.

2.4 AUDIT RESPONSIBILITIES AND RESOURCES

Audit responsibilities

The Auditor-General is responsible for the external audits of most Victorian public sector entities. Audit responsibilities include administrative units, public bodies such as government business undertakings, post secondary educational institutions, public hospitals and State funded nursing homes, companies and joint ventures, water and sewerage authorities and superannuation funds. At 30 June 1993, the Auditor-General had responsibility for the financial and performance audits of 526 organisations. Table 2.1 provides details of audit responsibilities by type of auditee.

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TABLE 2.1

Victorian Auditor-General's Office - Audit Responsibilities by Type of Auditee as at 30/6/93

<table>
<thead>
<tr>
<th>Auditee</th>
<th>No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parliament of Victoria &amp; the State Parliament Refreshment Rooms</td>
<td>2</td>
</tr>
<tr>
<td>Administrative units (eg. Departments)</td>
<td>26</td>
</tr>
<tr>
<td>Public bodies (eg. government business undertakings)</td>
<td>123</td>
</tr>
<tr>
<td>Post secondary educational institutions</td>
<td>36</td>
</tr>
<tr>
<td>Public hospitals and State funded nursing homes</td>
<td>147</td>
</tr>
<tr>
<td>Superannuation funds</td>
<td>18</td>
</tr>
<tr>
<td>Companies and joint ventures</td>
<td>49</td>
</tr>
<tr>
<td>Water and sewerage authorities</td>
<td>131</td>
</tr>
<tr>
<td>TOTAL AUDITS</td>
<td>526</td>
</tr>
</tbody>
</table>

Source: Data extracted from the Victorian Auditor-General’s Office 1993 Annual Report.

Staffing

The Victorian Auditor-General’s Office is the organisational structure which enables the Auditor-General to fulfil his legislative responsibilities. At 30 June 1993, the Audit Office employed 160 staff. The majority of the Auditor-General’s staff are qualified accountants although some staff are recruited from other professional disciplines. Staff undertake both performance and financial audits with approximately 40% of in-house resources or 29% of total resources allocated to performance audits during the 1992/93 financial year. Figure 2.1 provides details of total resources allocated to performance and financial audits over the past 4 years.

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3 Ibid., page 43.
Figure 2.1

Total Resources Allocated to Financial and Performance Audits

Source: Data provided by the Victorian Auditor-General's Office.

Contractual arrangements

The Office also engages private practitioners to act as agents of the Auditor-General. Audit assignments undertaken by agents are primarily of an attest nature and represented approximately 29% of the Office's total audit responsibilities in 1992/93. The majority of attest audits in the health, education, superannuation and water sectors are performed by contracted agents. Information technology reviews and
rate of return reporting requirements for certain auditees also involve contractual audit arrangements and external experts are utilised for some aspects of performance audits. The Auditor-General retains ultimate responsibility for these audits and must therefore ensure that the work performed by agents is of an acceptable standard. Figure 2.2 provides details of in-house and contracted resources allocated to audits over the past 4 years.

Figure 2.2

Contracted and In-house Resources Allocated to Audits

Source: Data provided by the Victorian Auditor-General's Office.
Funding and fees

The Office is funded by Parliamentary appropriations. Public bodies are required, under the Annual Reporting Act 1983 and other enabling legislation, to pay to the Consolidated Fund, amounts to defray the costs of their audits. The Audit Office is responsible for collecting these fees on behalf of the Consolidated Fund.

Prior to 1 July 1993, the Auditor-General’s Office was not empowered to recover the costs associated with the audits of administrative units. The Government’s budgetary arrangements from 1993/94 aim to include a more widespread use of inter-departmental charges in order to ensure that departments are held accountable for all of their operational costs. In line with this, from 1993/94, all departments are required to meet the costs of external financial audits from their own budgets.

The Office’s total payments for the 1992/93 financial year amounted to approximately $14 million. Approximately $10 million was collected in audit fees from the various public bodies on behalf of the Consolidated Fund.4

2.5 Audit Reports

Many of the Auditor-General’s reports are prepared under the authority of the Audit Act 1958. Auditor-General Reports which are tabled in Parliament comprise:

- Report on the Finance Statement - this is required under section 47 of the Audit Act 1958 and accompanies the Finance Statement. It provides an analysis of Consolidated Fund financial operations for the year as well as an analysis of the financial position of the State budget sector.

- Special Reports - on individual, significant performance audits.

- Report on Ministerial Portfolios - summarises the most significant issues identified during the audits of administrative units and public bodies.


The Auditor-General has no executive power to implement the recommendations contained in his reports. The Parliament, individual Ministers, central agencies and auditees have the power to determine whether or not the Auditor-General's recommendations should be implemented and to take action, where deemed necessary, to instigate changes.

In addition to reports to Parliament, the Auditor-General provides audit reports to the Commonwealth Government on expenditure of various funds provided by the Commonwealth to the State. Annual audit reports, interim reports and management letters are also issued to auditee management. These contain any issues which the Auditor-General considers are of concern and may include findings and recommendations on internal control weaknesses, inefficiencies observed during the audit or potential areas of risk. Copies of annual and interim audit reports are also forwarded to the Minister for Finance and the responsible Minister.
CHAPTER THREE: RISK ASSESSMENT

3.1 AUDIT PLANNING AND RISK ASSESSMENT

The planning process is central to the successful conduct of any audit. It defines the scope and objectives of the audit and enables the auditor to select audit procedures which make efficient and effective use of available resources. It should also target audit attention at those areas deemed to be significant (or material) and areas which potentially represent the greatest risk.

The planning process includes:

- developing an understanding of the organisation and its environment
- assessing risk
- assessing material (or significant) matters
- preparing an overall audit plan or strategy
- preparing a detailed audit program
- developing an audit budget

An overall risk assessment is performed by the auditor at the planning stage of the audit based on the auditor's knowledge of the entity's business, industry, management, financial performance, control environment and other matters. Factors which would contribute to higher levels of risk might include financial losses, speculative investments, pending litigation and discovery of mis-statements in prior financial statements.

Once potential risks have been identified, the auditor performs a preliminary assessment of the controls which senior management have put in place to identify and manage those risks. If the controls are absent or are not working effectively there are likely to be recurring problems at the operational level of the organisation.

Auditors plan and conduct an audit so that there is a reasonable expectation of detecting mis-statements which, individually or in aggregate, are material in relation to the information on which the auditor is reporting. There is an inverse relationship between the acceptable materiality level and the level of risk. Where risk increases the acceptable level of materiality would be reduced in order to ensure the adequacy of audit procedures performed. The auditor's assessment of risk
and/or materiality may alter during the course of an engagement, for example, as a result of the audit procedures performed. If this occurs, the audit program should be modified accordingly.

In assessing risk and materiality in the public sector, the auditor may perform an overall assessment in respect of the whole of the public sector and may also perform individual assessments pertaining to specific entities. Ideally, an overall risk assessment would be performed initially in order to determine those areas, within the public sector, requiring the most attention.

In practice, the Auditor-General is restricted, to some extent in his ability to determine the work to be performed by his Office as he is required, under legislation, to perform the financial audits of all government departments and public authorities. As a result, some entities may be subject to more detailed audit scrutiny than would otherwise occur if entities were assessed solely on the basis of potential risk and/or materiality in relation to the public sector as a whole. Approximately seventy percent of total Audit Office resources are applied to these financial audits at the current time.

3.2 THE ROLES AND RESPONSIBILITIES OF THE CENTRAL AGENCIES

Public sector officials are entrusted with public resources and owe a duty of accountability to the Parliament and the community it represents. Central agencies play a major role in this accountability process with their management having responsibility for overseeing the practices of public sector entities in order to ensure that the resources employed by those entities are utilised efficiently and effectively and in accordance with prevailing policies and practices.

There are three central agencies within the Victorian public sector. These comprise the Department of the Premier and Cabinet, the Department of Treasury and the Department of Finance. The responsibilities of the central agencies include the development of policies and strategies aimed at maximising financial and resource management, assessing the efficiency and effectiveness of Government programs and advising on and/or monitoring the financial aspects of major infrastructure proposals, debt management, accounting and audit policies, revenue raising strategies and other matters.
Mr Fergus Ryan, during his performance audit review, noted that the roles and functions of the central agencies are key to ensuring that the pervasive management and financial controls are in place within the public sector. He pointed out that if central agency policies and procedures are not in place or are not operating effectively in key areas, the consequences could flow into the public sector at large.

3.3 RISK ASSESSMENT AND THE CENTRAL AGENCIES

3.3.1 Mr Fergus Ryan's Findings and Recommendations

Mr Ryan noted that the Auditor-General's approach to risk assessment, with exceptions, could generally be described as entity specific. It was noted that:

"There is a significant opportunity to enhance the risk identification process within the total public sector if the Auditor-General in the first instance concentrates more on those agencies that have a responsibility to ensure that the pervasive management and financial controls are in place - that is, the Central Agencies."  

It was recommended that the Auditor-General use his performance audit methodology to undertake reviews of the central agencies in order to determine whether or not these agencies are achieving their objectives. Mr Fergus Ryan suggested that this approach to risk assessment would better enable the Auditor-General to identify and therefore prevent likely future problems.

Weaknesses identified in relation to the central controls over material and/or high risk areas may have significant repercussions on the overall operations of the public sector. By devoting attention to the central controls over material and/or high risk areas, the Auditor-General is better placed to detect any significant weaknesses.

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2 Ibid., page 30.
3 Ibid., page 29.
4 Ibid.
5 Ibid., page 30.
which may exist. Once identified, those weaknesses would be reported to the Parliament and/or management and appropriate action may be taken to rectify weaknesses. Accordingly, there exists the potential to prevent problems before they arise or become serious.

The Auditor-General, in response to a Committee questionnaire, has indicated that he regards the assessment of central agency risk management as a matter of high priority.6

Central agency risk assessment is a complex task. The Committee believes that the Auditor-General is the most appropriate person to undertake this task given his legislative responsibilities and the collective knowledge of the Victorian public sector within the Audit Office.

The Auditor-General also has the ability to utilise external consultants and experts to complement and supplement in-house expertise. As noted in Chapter 2, the Auditor-General currently contracts out 29% of his financial audits and also utilises external experts for some aspects of performance audits.

The Commonwealth Auditor-General, Mr John Taylor, has stressed that an Auditor-General should utilise experts, where necessary, in order to provide a quality audit service. Mr Taylor stated that it is not possible for an Auditor-General and his staff to perform all audit functions themselves as this would require too many staff and some staff would not be utilised the majority of the time.7

Mr Fergus Ryan supports the view that the Auditor-General should have responsibility for the assessment of central agency risk management. Mr Ryan's comments on this matter were sought by the Committee and are as follows:

"In my opinion, there are two clear benefits to my suggestion that the Auditor-General's annual audit cycle commence with an assessment of the critical cross-sectoral risk management functions of the Central Agencies. Firstly, those functions are obviously critical to effective management across the public sector. Therefore, any process which evaluates those functions, and provides the opportunity for improvement, will contribute to enhanced public sector management."

6 Auditor-General's response of 7 July 1993 to the Public Accounts and Estimates Committee Questionnaire, page 1.
7 Minutes of Meeting, 27 April 1993, attended by the Commonwealth Auditor-General and representatives of the Public Accounts and Estimates Committee, page 11.
Secondly, this process facilitates the Auditor-General’s identification and assessment of risk and, therefore, enables the focus of audit effort on those areas of most potential benefit. In other words, it contributes to the effectiveness of the Auditor-General’s own performance.

It needs to be recognised, however, that this proposal is “leading edge” in that it represents an advance on current public sector practice around the world. Further, it deals with complex and sensitive issues. It therefore follows that this process requires the Audit Office’s “best and brightest” - that is, the Auditor-General himself and the best of his senior staff.

It is also likely that there will be a need to involve external expertise. There is nothing particularly unusual in this - the Audit Office’s performance auditing methodology acknowledges that many performance audits will require particular skills or experience which will not be available from within the Office. The Office has considerable practical experience in introducing and managing external experts in its performance auditing process.” (Fergus Ryan, 27/8/93)

The Committee believes that the Auditor-General should undertake performance audits of the central agencies in accordance with Mr Fergus Ryan’s recommendations. Where necessary, the Auditor-General should utilise external consultants to supplement and complement the skill base within the Audit Office. Should the Auditor-General elect to utilise consultants, he is to retain ultimate responsibility for the overall conduct of the audits.

Finding 3.2

The Auditor-General is best placed to assess the adequacy of the risk management processes within the central agencies.

Finding 3.3

The Auditor-General is responsible for evaluating the procedures (or controls) which the managers of central agencies have put in place to enable them to identify and manage risks. If those controls do not exist or are inadequate, the Auditor-General has a responsibility to report any deficiencies to the Parliament and/ or management, as appropriate, so that action may be taken to rectify existing weaknesses.
Recommendation 3.1

The Auditor-General, in accordance with the recommendations outlined in Mr Fergus Ryan's Report on the performance audit of the Auditor-General, should review the critical objectives of the central agencies each year in order to determine whether the agencies are achieving those objectives.

Recommendation 3.2

In conducting performance audits of the central agencies, the Auditor-General should utilise external consultants and experts, where he believes this to be appropriate, in order to supplement and complement the existing skill base within the Audit Office.

3.3.2 Timing of Assessments

In a submission to the Committee, the Secretary to the Department of the Premier and Cabinet expressed the view that due to recent initiatives in public sector management, it would be counter-productive for the Auditor-General to assess the risk identification and management processes within the central agencies until the processes had been established on an on-going basis and the respective roles of the central agencies identified.  

The Auditor-General, in response to the Secretary’s submission has stated that an external performance audit, within the early stages, could still provide constructive input to assist management in the development, implementation and refinement of these processes.

The Committee is of the view that there are considerable benefits to be derived from early audit involvement in the assessment of central agency risk management processes. Such involvement assists the auditor in obtaining a good understanding of the systems (processes) being implemented and therefore contributes to the overall efficiency of the audit. Further, the auditor may provide assistance in identifying potential problems and in the development of solutions. This might provide management with the opportunity to rectify identified problems promptly.

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8 Submission to the Public Accounts and Estimates Committee from the Secretary to the Department of the Premier and Cabinet, July 1992, page 4.
Recent events have demonstrated that the potential risks within the public sector are too significant to defer the independent review of central agency risk management processes by the Auditor-General. This does not, however, mean that the Auditor-General would, or should, assume a management consultancy role.

Finding 3.4

Early audit review of risk identification and management processes within the central agencies is likely to increase the overall benefits derived from central agency audits and remains a priority given the State's potential risks.

Recommendation 3.3

Review of risk identification and management processes within the central agencies should be undertaken by the Auditor-General as soon as practicable and should not be deferred until the processes within the central agencies have been fully developed and implemented.

3.3.3 Impact of Recent Legislative and Administrative Changes on the Roles of the Central Agencies

In order to enhance the efficiency of the public sector, the Government has implemented various reforms which are intended to change the way in which the public sector is managed. The reforms involve the devolution of decision-making to departmental heads and Ministers and a reduction in the amount of detailed control exercised by the central agencies. At the same time, it is intended that the central agencies will maintain control of the Government's overall strategic directions. The Public Sector Management Act 1992 and the State Owned Enterprises Act 1992 provide the legislative framework for the Government's reforms.

The Public Sector Management Act 1992 was introduced for the purpose of reforming the way in which the budget sector is managed. Under section 13 of the Act, each department head has responsibility for ensuring the efficient, effective and economical management of his/her department.

The State Owned Enterprises Act 1992 was enacted to provide the legislative framework for the reform of government business enterprises (GBEs). Some entities, however, within the budget sector, will also be subject to reforms under the State
owned enterprises reform program, and will come under the Act. The program aims to enhance the efficiency of public sector entities through devolution of control to the managers. Under the program, management will be given greater autonomy and responsibilities and will be held accountable for their decisions through the monitoring of performance against predetermined performance targets.

The Department of the Premier and Cabinet will have increased responsibilities under the Public Sector Management Act 1992 for evaluating the operational performance of departments. Similarly, the Department of Treasury, under the State Owned Enterprises Act 1992, will assume responsibility for co-ordinating and overseeing the implementation of those policies relating to the reform of government business enterprises and will have ongoing responsibility for monitoring the performance of public sector businesses against predetermined performance targets. It is the Committee's opinion, therefore, that the central agencies will continue to play a significant role in the Victorian public sector.

In view of the significant responsibilities of the central agencies, Mr Ryan's comments and recommendations in relation to central agency risk management are considered to be relevant despite the recent legislative and administrative changes within the Victorian public sector.

**Finding 3.5**

Under recent legislative and administrative reforms within the Victorian public sector, the central agencies continue to have a major role in ensuring that public sector entities utilise resources efficiently and effectively and in accordance with prevailing policies and practices. The need for the Auditor-General to review central agency risk management processes therefore remains significant to the State.

### 3.3.4 Committee's Role in the Assessment of Risk

Mr Ryan indicated the need for better communication between Parliament and the Auditor-General and suggested that the former Economic and Budget Review Committee should facilitate the communication flow by, among other things, participating in the development of the Audit Office's annual performance audit.
plan. Mr Ryan suggested that improved communication would give the Auditor-General the opportunity to consider input and feedback from Parliament in formulating audit plans and would therefore aid in ensuring that the Auditor-General meets the needs and expectations of the Parliament. Mr Ryan, more recently has provided the Committee with the following comments on the Committee’s role in respect to the assessment of risk:

“I do not regard the Committee as having a role (in the sense of a responsibility) in risk assessment, per se. However, I think that the Committee is well-placed to contribute to the Auditor-General’s risk assessment process.

In my report I identified the Committee (or, more precisely, its predecessor, the Economic and Budget Review Committee (“EBRC”)) as having a critical role to play in facilitating communication between the Auditor-General and his primary client, Parliament. The responsibilities of the EBRC and its Public Accounts Subcommittee are summarised at Appendix IV to my report.

Assuming that the responsibilities of the Public Accounts and Estimates Committee are broadly similar, it is clear that the Committee is particularly well placed to provide valuable input to the Auditor-General based on members’ understanding of risk and risk management issues in the public sector. The provision of such input in no way compromises the Auditor-General’s independence, or his right to determine his own audit plan.” (Fergus Ryan, 27/8/93)

Auditors assess risk and materiality on the basis of their professional experience as well as their knowledge and understanding of the entity and the environment in which it operates. Much of the auditor’s decision-making process is judgemental. While guidelines are contained in accounting standards and auditing practice statements issued by the Australian accounting bodies, it is ultimately the auditor’s responsibility to make a decision as to what constitutes a risk and what is material (or significant).

An item is considered to be material in relation to a set of information if its omission or mis-statement is likely to have an impact on the decisions of the users of that information. Accordingly, an item may be material even if the dollar value is small. Any pecuniary interest by the managers of an entity, for example, would probably

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9 Ryan, F., op.cit., page 16.
10 Ibid.
be of interest to the shareholders of that entity, even if the amount involved was minimal.

The assessment of materiality and risk is not an exact discipline and the assessment process becomes more complex when applied to the public sector as a whole. Due to the size of the public sector, the majority of items or operations may not be material on the basis of dollar values. The assessment process will necessitate the formation of an opinion based on the anticipated needs and values of the users of information. These users include Members of Parliament who represent the interests of the community, and the requirements of individual users are likely to diverge considerably. The Auditor-General, at public hearing, highlighted this problem when he stated that he sees himself as the Parliament's auditor but he is not sure what Parliament wants.\footnote{Minutes of Evidence, 1 September 1993, page 22.} The Auditor-General further stated:

"I would see a greater interaction between the Auditor-General and the Committee being desirable. I certainly agree with Mr Ryan's suggestion that it would still be left to the professional judgement of the Auditor-General as to what issue should be pursued, otherwise one would find the Auditor-General being dragged into the political arena, and that would be undesirable."\footnote{Ibid.}

The Committee believes that the Public Accounts and Estimates Committee, as the primary contact between the Parliament and the Auditor-General, should have a role in contributing to the identification and assessment of risk within the public sector. This is consistent with the comments and recommendations made by Mr Fergus Ryan. It is recognised, however, that the independence of both the Audit Office and the Committee will need to be maintained.

The former Economic and Budget Review Committee formulated guidelines on the working relationship between the Committee and the Office of the Auditor-General in 1986. These guidelines recognised that the relationship between the Committee and the Audit Office must be such that it does not compromise the separate and independent roles and responsibilities of the two parties.

The Auditor-General should provide a copy of his performance audit plan to the Committee on an annual basis in order that the Committee be given the opportunity to discuss the plan with the Auditor-General and suggest subjects for performance

\footnote{Minutes of Evidence, 1 September 1993, page 22.}
\footnote{Ibid.}
audits. The Committee accepts that it should not be able to direct the Auditor-General to conduct specific audits as it is recognised that this would compromise the Auditor-General’s independence.

Finding 3.6

The Public Accounts and Estimates Committee, as the primary contact between the Auditor-General and the Parliament, should contribute to the Auditor-General’s assessment of risk within the public sector.

Recommendation 3.4

The Auditor-General should provide a copy of his performance audit plan to the Public Accounts and Estimates Committee on an annual basis and the Committee given the opportunity to discuss this plan with the Auditor-General and suggest but not dictate subjects for performance audits.

Finding 3.7

In order to clarify and enhance the relationship between the Public Accounts and Estimates Committee and the Auditor-General, the guidelines on the working relationship between the 2 parties will be revised to incorporate the Committee's role in the assessment of risk and other relevant matters. Input on revised guidelines and acceptance of completed guidelines will be obtained from both the Committee and the Auditor-General.

3.4 EXISTING BARRIERS

In November 1992, the Auditor-General wrote to the Secretaries of each of the 3 central agencies requesting details of the mechanisms they use to achieve their stated objectives. The aim of these requests was to enable a preliminary assessment of the controls exercised by the central agencies so that planning of performance audits of these agencies could be undertaken. Further requests were sent to all three agencies in April 1993. The Auditor-General has received only one substantial response to his requests. This response was received from the Department of Finance in May 1993.
The Auditor-General in response to a Public Accounts and Estimates Committee questionnaire stated that his Office is at present (July 1993) hampered in planning the scope and timing of central agency risk assessments because of the lack of information forthcoming from two of the agencies and the apparent reluctance of one of the agencies to participate in any performance audit reviews.\textsuperscript{13}

The Auditor-General has, on several previous occasions, raised the issue of departments having refused his officers access to information. In his 1992 Report on the Finance Statement, the Auditor-General reported that the Department of Treasury had refused access to correspondence relating to the State's dealing with Loan Council. The Auditor-General stated that:

"It is of concern that the Department of Treasury has taken the view that it can exercise discretion as to what information will be provided to my Office to enable the discharge of my responsibilities to the Parliament. The Department's position is clearly contrary to the Audit Act 1958, which gives my Office unrestricted access to any information required."\textsuperscript{14}

In a public hearing on 24 February 1993 the Auditor-General stated:

"I can cite four possible cases in which the Office has reported to Parliament that the Treasury, in particular, has failed to be forthcoming with information that is needed to assess effectiveness."\textsuperscript{15}

The \textit{Audit Act} 1958, gives the Auditor-General the power to obtain whatever information he deems necessary to discharge his statutory responsibilities. Section 39 of the \textit{Audit Act} 1958 states that:

\begin{enumerate}
\item Without prejudice to any other powers under this Part the Auditor-General may make such queries and observations addressed to the Treasurer or any other person whomsoever and call for such accounts vouchers statements documents and explanations as he thinks necessary.
\end{enumerate}

\begin{flushright}
\textsuperscript{13} Auditor-General's response of 7 July 1993 to the Public Accounts and Estimates Committee Questionnaire, page 2.
\textsuperscript{15} Minutes of Evidence, 24 February 1993, page 2.
\end{flushright}
(2) Every such query and observation received by any person other than the Treasurer shall within fourteen days after its receipt by that person be returned by him with the necessary reply to the Auditor-General.

Section 44 of the Act states that:

(1) The Auditor-General may under his hand in the form in the Sixteenth Schedule or to the like effect require all such persons as he thinks fit to appear personally before him at a time and place named, and to produce to him all such accounts books and papers in the possession or control of such persons as appear to be necessary for the purposes of their examination.

(2) The Auditor-General may when he sees occasion cause search to be made in and extracts to be taken from any book or record in the custody of the Treasurer or of any department or of any public authority without paying any fee.

(3) The Auditor-General may examine upon oath (which oath he is hereby empowered to administer) all persons he thinks fit to examine relating to the receipt and expenditure of money or stores and all other matters and things necessary for the due execution of the powers vested in him by this Act.

Under section 45 of the Audit Act 1958 it is an offence to fail to appear before the Auditor-General, to withhold documents, to fail to answer questions, to make false declarations or to willfully and corruptly give false evidence.

A significant amount of time has elapsed since the Auditor-General wrote to the three central agencies requesting information which would enable the Audit Office to plan performance audits of the central agencies. To July 1993, only one of the agencies has responded positively to the Auditor-General’s request. The Committee regards the assessment of central agency risk management as a high priority and believes that the progress made, towards this end, has been inadequate.

In order to evaluate risk within the public sector, the Auditor-General’s officers must have free access to all information held within the central agencies. Accordingly, the withholding of information by auditees is a significant problem for this State and needs to be addressed. Past reporting of incidences to the Parliament does not appear to have resulted in a satisfactory solution to the problem.
When questioned at public hearing, the Auditor-General expressed reluctance to exercise his powers under the *Audit Act* 1958, to obtain information, pointing out that such action would not be conducive to developing a better relationship with auditees and expressing the view that such action was not warranted at that stage.\(^\text{16}\)

Refusal by an auditee to release information, in the Committee's view, may be indicative of a poor relationship between the auditee and the Audit Office. It is therefore considered doubtful that action, by the Auditor-General, to obtain access to information, could significantly undermine the Audit Office's existing relationship with the auditee concerned. Further, it is arguable that the reporting of an offending department, to the Parliament, may also be detrimental to the relationship between the management of that department and the Audit Office.

The Committee holds the view that the Auditor-General should utilise his powers under section 44 of the Act, where necessary, to obtain the information he deems necessary to the conduct of his audits.

**Finding 3.8**

The Auditor-General has been hampered in proceeding with the risk assessments of central agencies due to lack of information forthcoming from 2 of the 3 agencies. On past occasions, the Auditor-General has also reported to the Parliament that his officers have been refused access to information.

**Finding 3.9**

In order to evaluate risk within the public sector, the Auditor-General's officers must have unrestricted access to all information held within the central agencies. Accordingly, the withholding of information by auditees is a significant problem which needs to be addressed.

\(^{16}\) Minutes of Evidence, 1 September 1993, page 6.
Recommendation 3.5

The Auditor-General should utilise his powers under the Audit Act 1958 to obtain required information from those agencies who fail to supply that information at the Auditor-General's request.

Recommendation 3.6

The Auditor-General should report any problems encountered in obtaining information from auditees to the Parliament and/or the Public Accounts and Estimates Committee, as appropriate.

Recommendation 3.7

Utilisation of powers provided under section 44 of the Audit Act 1958 should be reported to the Parliament, by the Auditor-General, along with details of the outcome of this course of action.

3.5 RELATIONSHIP OF THE WORK OF THE AUDITOR-GENERAL AND THAT OF THE CENTRAL AGENCIES

In a letter to the Auditor-General, the Secretary to the Department of the Premier and Cabinet indicated that the recently established Office of Public Sector Management (OPSM) within that Department would review management efficiency and program effectiveness and appropriateness, while the Auditor-General should report to Parliament principally on the issue of compliance. In view of the Secretary’s comments, the Committee believed it was appropriate to further explore the roles of the Auditor-General and the Office of Public Sector Management.

The Office of Public Sector Management was recently established within the Department of the Premier and Cabinet to perform the management review and evaluation functions provided for under the Public Sector Management Act 1992. The Act provides extensive powers to the Minister responsible for administering the Act and therefore to the Office of Public Sector Management within the Department of the Premier and Cabinet. The OPSM supports the Premier as the Minister administering the Public Sector Management Act.

Letter to the Auditor-General from the Secretary to the Department of the Premier and Cabinet, June 1992, page 2.
Section 74 of the Act provides the authority for the Office of Public Sector Management to conduct performance reviews on various aspects of government. These reviews may relate to either across the board issues or may involve an examination of a specific department. Section 72 of the Act gives Office of Public Sector Management staff the authority to enter the premises of any department or prescribed office, to examine documents and to require staff to answer questions.

The duties to be performed by the Office of Public Sector Management primarily involve the review and evaluation of various internal control mechanisms operating within the public sector. The role of the Office of Public Sector Management within the public sector is therefore similar to that of an internal audit department within an organisation.

The OPSM has a significant role to play in improving overall management performance within the public sector. The work performed by the OPSM however, cannot substitute for, or replace the work undertaken by the Audit Office as the OPSM lacks the necessary level of independence. Further, the reports of the Auditor-General are tabled in Parliament and are available to the public. It is unlikely that the Parliament and/or the public would have similar access to reports prepared by the OPSM. If the Auditor-General's staff, however, are able to establish that the OPSM is operating effectively, reliance may be placed on this internal control mechanism to reduce the amount of detailed work undertaken by Audit Office staff at the various government departments.

The Committee sought Mr Fergus Ryan's views on the roles and responsibilities of both the OPSM and the Auditor-General, and received the following response:

"The roles and responsibilities of OPSM and the Auditor-General are in my view clearly complementary.

It is entirely consistent with the broad cross-sectoral responsibilities of the Central Agencies that a mechanism be established within the Central Agencies to monitor the performance of public sector entities. Indeed, a situation in which the Auditor-General is the only person undertaking evaluations of the performance of public sector entities is contrary to the clear basic premise that the primary responsibility for the effective conduct of public sector operations lies with the public sector itself, and not with the Auditor-General."
At page 30 of my report I described a process whereby the Auditor-General would undertake a review of the critical cross-sectoral Central Agency functions at the commencement of each annual audit cycle. I would expect this review would include an evaluation of the effectiveness of OPSM. An understanding by the Auditor-General of the nature, scope and results of OPSM's reviews in the previous twelve months, and its plans for the coming twelve months, would therefore clearly be useful input to him in determining where his performance auditing resources could then best be applied.

Again, this process should in no way be considered as a constraint on the Auditor-General's sole prerogative to determine his audit plan. Nevertheless, common sense suggests that the review program of OPSM would be a factor which the Auditor-General would take account of in his risk assessment and planning process.” (Fergus Ryan, 27/8/93)

The Auditor-General, in a public hearing, has recently stated that he believes that the Secretary to the Department of the Premier and Cabinet now agrees that the performance reviews conducted by the Office of Public Sector Management would not be in lieu of performance audits undertaken by the Audit Office but would, instead, complement the Auditor-General's work.18

In order to minimise duplication and ensure the efficient and effective utilisation of resources, the Auditor-General should have access to all documentation associated with the performance reviews conducted by the OPSM.19 Similarly, any documentation held by the Office of State Owned Enterprises within the Department of Treasury in respect to either the special investigations conducted under the authority of the State Owned Enterprises Act 1992 or the performance monitoring of GBEs (refer section 3.3.3), should be made available to the Audit Office.

18 Minutes of Evidence, 1 September 1993, page 2.
19 The Committee’s conclusion is supported by advice received from Mr Fergus Ryan - Minutes of Meeting with Mr Ryan, 28/7/93.
Finding 3.10

The roles and responsibilities of the Office of Public Sector Management within the Department of the Premier and Cabinet and the Office of State Owned Enterprises within the Department of Treasury complement, rather than substitute for, the roles and responsibilities of the Auditor-General.

Recommendation 3.8

The Auditor-General should have access to all documentation, including strategies and work programs, associated with the special investigations and performance reviews undertaken by:

- the Office of Public Sector Management within the Department of the Premier and Cabinet; and

- the Office of State Owned Enterprises within the Department of Treasury.

These reviews should be assessed and where appropriate, utilised to reduce detailed work undertaken by Audit Office staff at the various government departments and authorities.
CHAPTER FOUR: ENTITIES NOT SUBJECT TO AUDIT BY THE AUDITOR-GENERAL

4.1 AUDITOR-GENERAL'S AUDIT MANDATE

The authority of the Auditor-General to conduct financial audits of public sector entities is provided under section 31(1) of the Audit Act 1958 (the Act), which requires the books and accounts of all public authorities to be audited at least once every year by the Auditor-General. Under section 48A of the Act, performance audits of government departments and public authorities may be undertaken at the Auditor-General's discretion.

The Act defines a public authority as an authority, the accounts of which the Auditor-General is required to audit under State legislation or at the request of the Treasurer. Where the Auditor-General is not required to audit the accounts of an authority the Auditor-General would have no mandate to conduct a performance audit of that entity under the Audit Act 1958.

The Audit Office has advised the Committee that the Audit Act has been applied fairly broadly by Treasurers in the past. The Auditor-General has been requested to undertake the audits of companies which are directly owned by the government as well as wholly or majority owned subsidiaries of government entities.

4.2 STATE OWNED ENTERPRISES

Recent legislative changes

The Government has instigated a program which aims to reform the way in which government business enterprises (GBEs) operate. The State Owned Enterprises Act 1992 was enacted to provide the legislative framework for the restructuring, corporatisation and possible privatisation of publicly-owned business entities.

The operation of the State Owned Enterprises Act 1992 may remove public sector entities from the audit mandate of the Auditor-General. GBEs which are corporatised under the Act become State owned enterprises (SOEs) and depending on their corporate form, may or may not be subject to audit by the Auditor-General's Office.
Table 4.1 summarises the Committee’s understanding of the Auditor-General’s legislative role in respect of GBEs. A discussion of the Committee’s rationale for table 4.1 follows later in this section.

**Table 4.1: The Auditor-General’s Role in the Audit of Government Business Enterprises**

<table>
<thead>
<tr>
<th>Entity</th>
<th>Financial Audit</th>
<th>Performance Audit</th>
<th>Relevant Legislation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Authority</td>
<td>Yes</td>
<td>Yes</td>
<td>Audit Act</td>
</tr>
</tbody>
</table>
| State Business Corporation | Yes           | Possibly           | Audit Act  
|                         |                 |                   | State Owned Enterprises Act  |
| State Owned Company     | Unclear         | Appears not        | State Owned Enterprises Act   |

Given that the Auditor-General is an integral part of the accountability process under the Westminster system of government, the Committee believed that it was necessary to explore the implications of the *State Owned Enterprises Act* on public sector accountability. This requires an understanding of the underlying objectives of the Government’s strategy as well as an understanding of the roles and responsibilities of GBEs and their impact on the Victorian economy.

*Government business enterprises and their contribution to the Victorian economy*

Government business enterprises are publicly owned entities which provide goods or services on commercial terms. These entities aim to recover their costs of production through direct user charges and in most cases also aim to provide some financial return to their owner (the State). Victoria’s major GBEs comprise the Gas and Fuel Corporation of Victoria, the State Electricity Commission of Victoria, the Melbourne Water Corporation, the Totalizator Agency Board, the Grain Elevators Board and the Port of Melbourne Authority.
Victoria's GBEs provide essential infrastructure and services to households as well as to industry, make a significant contribution to the State's revenue and employ a large number of Victorians. They also utilise the State's scarce economic resources and the way in which they manage the public sector assets within their control impacts on the economic and social well-being of Victorian citizens.

Dividends are payable to the State Government by some of the State's GBEs. In addition, the Totalizator Agency Board makes large annual contributions to the Health Budget and to the Consolidated Fund. These contributions are not required under the Public Authorities (Dividends) Act 1983 but are calculated instead on the basis of statutory prescribed formulae. The GBEs also make indirect contributions to the State by performing unfunded community service obligations. The development of parks and of waterways are examples of community services provided.

Statistical data extracted from the Report of the Victorian Commission of Audit is included in Table 4.2. This data demonstrates the significance of the State's GBEs to Victoria's economic performance.
Table 4.2: Key Statistical Data Related to GBEs

Assets and Liabilities of GBEs as at 30 June 1992

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets of GBEs</td>
<td>$22.3 billion</td>
</tr>
<tr>
<td>Total public sector assets (substantial assets not recognised)</td>
<td>$64.5 billion</td>
</tr>
<tr>
<td>Assets of GBEs - % of total public sector assets</td>
<td>34%</td>
</tr>
<tr>
<td>Total liabilities of GBEs</td>
<td>$16.1 billion</td>
</tr>
<tr>
<td>Total public sector liabilities</td>
<td>$69.8 billion</td>
</tr>
<tr>
<td>Liabilities of GBEs - % of total public sector liabilities</td>
<td>23%</td>
</tr>
</tbody>
</table>

Combined Annual Turnover of GBEs

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>$7.0 billion</td>
</tr>
<tr>
<td>Percentage of Victoria’s gross State product</td>
<td>7%</td>
</tr>
<tr>
<td>Percentage of national gross domestic product</td>
<td>2%</td>
</tr>
</tbody>
</table>

Contribution to Employment by GBEs in 1991/92

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of total public sector employment</td>
<td>13%</td>
</tr>
<tr>
<td>Percentage of total State employment</td>
<td>2%</td>
</tr>
</tbody>
</table>

Total Contributions to the Victorian Government in 1991/92

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>$874.9 million</td>
</tr>
<tr>
<td>Percentage of total State current revenue and grants</td>
<td>8%</td>
</tr>
<tr>
<td>Percentage of State sourced revenue</td>
<td>13%</td>
</tr>
</tbody>
</table>


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1 Due to inadequate asset records within some Government departments and difficulties associated with valuing a range of assets such as crown land, mineral and energy reserves and heritage assets, it was not possible for the Commission to ascertain the full value of Government assets. The amount of $64.5 billion therefore under-estimates the total value of assets owned by the State.
The aims of corporatisation and privatisation

Corporatisation aims to ensure that the operational and management practices of GBEs are similar to those of private sector firms. This would generally involve defining clear commercial objectives, providing an appropriate level of management autonomy, responsibility and accountability and monitoring the performance of managers against predetermined performance targets. Corporatisation may also involve exposing public sector entities to greater competition in order to prevent the possible abuse of market power. Corporatisation does not necessarily entail incorporation of an entity under Corporations Law.

Privatisation is the transfer, by sale or other means, of assets or operations from the public sector to the private sector. Some of the aims of privatisation might include the production of efficiency gains by fostering of greater competition, improving the quality of services provided to consumers, the introduction of new management expertise and the reduction of public sector debt.

GBEs and the Government's reform program

The Government's program will entail a major re-organisation of the public business sector and a significant increase in private sector provision of services. It is intended that there will be extensive contracting out of services previously provided by government entities as well as restructuring, corporatisation and possible privatisation of various existing public sector business enterprises. The Government also intends to introduce competition into the markets in which monopolistic GBEs operate in an attempt to improve the overall efficiency of organisations operating within those markets. According to the Treasurer:

"The reform program aims to create greater efficiency in the use of the State's total resources, through effective and sustainable competition; empower consumers by providing choice; and assist in curbing the growth in the State public sector debt.”

Under the program, the Heatane Division of the Gas and Fuel Corporation was sold to Elgas and the Government has also sold part of its interest in the Portland

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Smelter, thereby reducing the State’s participating interest in that entity from 35 per cent to 25 per cent. 4

The 1993/94 Budget Papers provided details of a number of reforms including: 5

- the possible privatisation of both the BASS ticketing division of the Victorian Arts Centre Trust and the State’s remaining interest in the Portland Smelter.

- the proposed privatisation of the Grain Elevators Board.

- initiation of the reform of the Government Employee Housing Authority, the three port authorities and the Transport Accident Commission, all of which have been declared reorganising bodies under the State Owned Enterprises Act 1992.

- the proposed major restructuring of entities such as the State Electricity Commission of Victoria (SECV) and the Gas and Fuel Corporation of Victoria, including the splitting of the SECV into three separate businesses in order to separate the generation, transmission and distribution processes.

- the future contracting out of various services which are currently provided by public sector entities.

- initiation of commercialisation and corporatisation of State owned plantations.

- the intended corporatisation of the Urban Land Authority.

The State Owned Enterprises Act 1992 provides for several corporate forms. The State business corporation and the State owned company are the 2 basic corporate models. The remaining 2 models (reorganising body and State body) are transitional only. The Treasurer in his 6 April 1993 Statement outlined the purposes of the specific corporate models as follows: 6

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• Reorganising body - As a temporary measure, government entities may be declared reorganising bodies under the Act where the Treasurer has wide discretion to ensure that the affairs of the entity are re-arranged.

• State body - Government entities or parts of government entities may come under the Act through establishment as a State body. This form is envisaged for enterprises undergoing significant rearrangement or splitting of functions.

• State business corporation - This form is planned for government entities which are to remain in Government ownership but with an enhanced commercial focus, or alternatively, for those entities which require a period of time to adopt a commercial culture prior to partial or full privatisation.

• State owned company - Will be incorporated under the provisions of Corporations Law and will be required to comply with Corporations Law and the entity's constitution.

State business corporations

Under the State Owned Enterprises Act a State business corporation is defined as a statutory corporation declared by Order in Council to be a State business corporation.

Section 58 of the StateOwned Enterprises Act 1992 sets out the auditing requirements relating to State business corporations. Under section 58(1) of the Act, the Auditor-General is responsible for auditing the financial statements of State business corporations. The Act does not make any provisions for the performance audits of these entities. Accordingly, the Auditor-General will not have the ability to conduct a performance audit unless this mandate is provided under the Audit Act 1958.

In order to come within the ambit of the Audit Act 1958, a State business corporation would need to fall within the definition of a public authority. Under the Audit Act, a public authority is defined as follows:

"'public authority' means public authority the accounts of which the Auditor-General is required to audit by law or at the request of the Treasurer".
It is possible that the current definition of a public authority under the Audit Act 1958 does not encompass those entities declared to be State business corporations under the provisions of the State Owned Enterprises Act. It is therefore possible that the Auditor-General will not have a mandate to conduct performance audits of State business corporations unless the Treasurer so requests.

State owned companies

Under the State Owned Enterprises Act a State owned company is defined as a company declared by Order in Council to be a State owned company.

Section 73 of the State Owned Enterprises Act sets out the auditing requirements for State owned companies as follows:

(1) The Auditor-General may, and if the articles of a State owned company so provide, must, act as auditor of a State owned company.

(2) The Auditor-General, and any person authorised by the Auditor-General, has in respect of an audit of a State owned company all the powers of an auditor under the Corporations Law.

The Statement in section 73(1) that the Auditor General may act as auditor of a State owned company appears to provide a discretionary power, to the Auditor-General, to undertake the financial audit of any State owned company. This is, however, not explicitly stated and the section could be interpreted to mean otherwise. It is unclear as to whether the word 'may' in this section of the Act refers to permission or opportunity, or has been used instead to express a possibility.

Whether the Auditor-General is the appointed auditor by way of provision in the company's articles of association or by exercising his discretion to audit the entity, section 73(2) of the Act seems to preclude the Auditor-General from conducting a performance audit as the Corporations Law is limited to financial audits.

Proposed changes to legislation

The Committee wrote to the Treasurer seeking clarification of the proposed auditing arrangements for the State Electricity Commission of Victoria after the restructuring and corporatisation of that entity.
The Treasurer, in response to the Committee’s letter, has indicated that the Auditor-General, under the *State Owned Enterprises Act* 1992 and the *Audit Act* 1958, will be responsible for the financial and performance audits of the State Electricity Commission. He further stated that:

"In general, given the Government’s financial and electoral accountability for Government Business Enterprises (GBEs), I believe that the Auditor-General should be the auditor of public bodies."\(^7\)

Legislation proposals scheduled for presentation during the current session of Parliament provide for an amended *Audit Act* as well as a *Financial Management Act*. The proposed legislation is intended to consolidate the financial management, reporting and accountability requirements which are currently contained in the *Public Account Act* 1958, the *Audit Act* 1958 and the *Annual Reporting Act* 1983. Details of the proposed legislation are not known, by the Committee, at this stage. In view of the Treasurer’s comments, it is possible that the Auditor-General may be given a mandate, under amended and/or new legislation, to conduct financial and performance audits of GBEs.

**Conclusion.**

In recent years, public bodies and government agencies have increasingly used companies, trusts, joint ventures and incorporated associations to conduct a range of activities on their behalf. Governments have also moved to the use of companies and trusts with the aim of removing public sector constraints and applying private sector management strategies in an attempt to improve the delivery of public sector services.

The Commonwealth Senate Standing Committee on Finance and Administration found that the increasing use of corporate forms in the Australian Government sector also coincided with a trend towards greater use of private sector auditing firms for the external audits of new companies.\(^8\)

Where audits of public sector entities are undertaken by private sector firms rather than by the Auditor-General, there is a reduction in accountability. This is because

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\(^7\) Treasurer’s letter of 3 September, 1993 to the Public Accounts and Estimates Committee.

the Auditor-General reports directly to the Parliament on the results of his performance and financial audits while private sector auditors do not have a similar requirement under the Corporations Law.

In his 1990/91 Report on the Finance Statement, the Auditor-General stated that:

"... the growing practice of using companies, trusts, joint ventures and incorporated associations to conduct a widening range of activities, on behalf of public bodies and government agencies, has reduced the effectiveness of the traditional accountability framework to the Parliament and the taxpayer."\(^9\)

Some have argued that the traditional form of public accountability is not appropriate to government business undertakings as it may inhibit the ability of managers to act in a commercial way and thereby reduce possible efficiency gains.

The Commonwealth Senate Standing Committee on Finance and Administration found that the move away from audit by the Auditor-General appeared to be based on a misunderstanding of the role of an auditor. The Committee stressed that the external audit is not undertaken primarily to assist management but rather to provide owners with an independent report on management performance.\(^{10}\)

The Senate Standing Committee questioned the premise that an entity's legal form could play a significant part in achieving greater efficiency and said that it was unacceptable for a government entity to be able to take on a form which would enable the reduction or avoidance of proper accountability.\(^{11}\)

A number of Commissions and Parliamentary committees have recently recommended that Auditors-General, within Australia, have sufficiently broad mandates to ensure the adequacy of accountability within the public sector.

The Queensland Parliamentary Committee for Electoral and Administrative Review in 1992 endorsed the Queensland Electoral and Administrative Review

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10 Senate Standing Committee on Finance and Administration, the Parliament of the Commonwealth of Australia, op. cit., page 37.
11 Ibid., pages 26 and 28.
Commission's recommendation that any legislation to regulate GBEs should state that the Auditor-General is to audit the accounts of all GBEs.12

The Joint Committee of Public Accounts (JCPA) recommended that the Commonwealth Auditor-General be reinstated as the external auditor of Statutory Marketing Authorities and GBEs and that the Commonwealth Audit Act 1901 be amended to require that the Auditor-General be appointed external auditor of all government companies. It was also recommended that the subsidiaries of all statutory authorities, government owned companies and GBEs be audited by the Auditor-General.13


More recently, the Victorian Audit Commission recommended that the Victorian Audit Office should be responsible for the external audits of all public sector entities, including State owned enterprises and companies and joint ventures where the Government has a controlling interest.16

Considerable reforms have occurred in respect to the management of the New Zealand public sector in recent years with the implementation of extensive corporatisation and privatisation programs. Section 19 of the New Zealand State-Owned Enterprises Act 1986 states that

"..... the Audit Office shall be the auditor of every State enterprise, and of every subsidiary of every such State enterprise ....."

14 Senate Standing Committee on Finance and Administration, the Parliament of the Commonwealth of Australia, op. cit., page 45.
There is greater need for accountability in the public sector than in the private sector because taxpayers' funds are utilised by government and taxpayers expect their monies to be used for the ultimate benefit of the community. In particular taxpayers, unlike company shareholders, do not become owners of GBEs by expressed choice and therefore expect a higher standard of accountability. Accordingly, they have a right to assurance that funds provided by way of taxes and charges are spent in accordance with legislation and that services provided by government reflect value for money.

GBEs play a fundamental role in the Victorian economy and the way in which they are managed impacts directly on the community at large. In order to ensure that GBEs are adequately accountable for funds utilised, it is appropriate that the Auditor-General has responsibility for the financial audits of all GBEs.

The Committee does not believe that GBEs should be excluded from the Auditor-General's performance audit mandate. A review of a GBE's financial results alone will seldom provide an accurate reflection of performance because these results do not include the value of social (community service) obligations provided by a GBE. Further, financial results are largely dependent on the charge-out rates and in the absence of competitive market forces, there are no guarantees that quality services are being provided to consumers at the lowest possible price.

Finding 4.1

The Auditor-General is responsible for informing the community, through the Parliament, about the probity and quality of the Government's stewardship of public resources. Given the substantial investment of public sector funds in Victoria's government business enterprises together with the significant economic and social impact of these entities, the Auditor-General should retain responsibility for the financial and performance audits of government business enterprises irrespective of their legal form.

Recommendation 4.1

The legislative mandate for financial and performance audits by the Auditor-General should be broadened to ensure that it captures all government business enterprises including the various forms of State owned enterprises as part of the current legislative reforms.
4.3 ENTITIES CONTROLLED BY THE STATE

The Audit Act provides the Auditor-General with a mandate to audit all public authorities. This mandate does not extend to entities which are subsidiaries of public authorities unless the Auditor-General is required to audit the accounts by other legislation or at the request of the Treasurer. Notwithstanding this, the Auditor-General may have some auditing rights and responsibilities in respect to an entity which is deemed to be a controlled entity and forms part of the consolidated accounts of a department or authority which the Auditor-General is required to audit.

Requirements relating to the preparation of consolidated accounts for companies are detailed in Accounting Standard AASB 1024 - Consolidated Accounts while consolidation requirements for other reporting entities are documented in Australian Accounting Standard AAS 24 - Consolidated Financial Reports.

The standards require a parent entity to prepare consolidated accounts where:

- one entity can be identified as a parent and the other a subsidiary; and

- the parent/subsidiary relationship is that of control of the subsidiary by the parent; and

- the parent entity is a reporting entity in relation to an economic entity or the parent entity prepares a financial report which it purports to be a general purpose financial report for an economic entity which is not a reporting entity.

The standards adopt the criterion of control for defining an economic entity which comprises a parent and its subsidiary entities.

Normally, control would exist when an entity holds more than fifty percent of the shares in another entity because the holding of an ownership interest usually entitles the investor to an equivalent percentage in the voting rights of an investee. It is possible however, for a controlling entity to have a shareholding which is less than fifty percent and, conversely, for control to be absent even where the shareholding is in excess of fifty percent.
An entity would normally control another entity if it is in a position to:

- dominate the composition of the board of directors;
- appoint or remove a majority of the directors;
- cast or control the casting of a majority of the votes at directors' meetings;
- cast or regulate the casting of a majority of the votes at a general meeting of shareholders; or
- effect a statute, trust deed, or other scheme or device which gives the controlling entity the capacity to enjoy the majority of the benefits and be exposed to the majority of the risks, notwithstanding that control may appear to be vested in another party.

The following factors either singly or in combination might constitute a control relationship in the public sector:

- Ministerial approval of operating budgets;
- the power of the Minister or central agency to appoint or remove members of the board of management; and
- Ministerial power or direction.

In order to render an opinion on consolidated accounts, the Auditor-General would be required, under Australian Statement of Auditing Practice AUP 11 - Using the Work of Another Auditor, to obtain reasonable assurance that the work performed by the auditor of the subsidiary entity, is adequate for his purpose. Such assurance may be obtained by review of audit reports and working papers. If the parent and subsidiary entities are both companies, the Auditor-General would also have right of access to the accounting records of the subsidiary entity under section 332(6) of the Corporations Law.

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17 Australian Accounting Standard, AAS24. Consolidated Financial Reports, issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, para. 22.
18 Ibid, para. 24.
Where the government holds a controlling interest in an entity and the Auditor-General is not the appointed auditor of that entity, the Auditor-General has no means of rendering an opinion on the entity's financial information unless that information forms part of the consolidated accounts of one of the Auditor-General's auditees. Even then, the work undertaken by the Auditor-General in relation to the subsidiary entity's financial information will be limited. Further, the Auditor-General will have no mandate to conduct a performance audit of the subsidiary entity.

In the Committee's view, it is undesirable that government entities, through the establishment of companies, trusts and other arrangements, have the ability to divert resources into entities with the result that accountability in relation to those resources is reduced.

In order to ensure adequate accountability and in light of the related discussion at section 4.2 of this report, the Committee believes that the Auditor-General should have responsibility for auditing all companies, partnerships, trusts, joint ventures and other entities in which the Government has a controlling interest.

**Recommendation 4.2**

Legislation should require that the Auditor-General audits all entities (including trusts, joint ventures, partnerships, companies and other entities) in which the State has a controlling interest.

### 4.4 ENTITIES IN WHICH THE STATE HAS A MINORITY INTEREST

Where the State holds a minority equity interest in an organisation but does not have the capacity to control the affairs of that organisation, the Auditor-General may, in theory, have some auditing obligations in respect to the minority holding but only if the organisation is deemed to be an associated company.

Statement of Accounting Standard AAS 14 - Equity Method of Accounting and Approved Accounting Standard ASRB 1016 - Disclosure of Information About Investments in Associated Companies, require all companies which have investments in associated companies to report these investments in equity supplementary financial statements. The Standards define an associated company
as an investee, not being a subsidiary of the investor company, over which the investor has significant influence.

In the case of an associated company the capacity to influence will be significant but will nonetheless fall short of dominance. Significant influence is defined as the capacity of the investor entity to substantially affect the financial and/or operating policies of the investee entity. Some of the factors which, singly or in combination, indicate the existence of significant influence might include the investor's voting power in the investee, representation on the investee's board of directors, interchange of management personnel and participation in the policy making decisions of the investee.

Significant influence will normally arise from the investor's voting power in the investee and will be dependent on the distribution of the balance of voting power. Where an investor holds twenty per cent or more of the voting power, this would lead, in the absence of evidence to the contrary, to a presumption that the investee has significant influence.

The auditor of an investor company is required under Statement of Auditing Practice AUP 18 - the Audit implications of Equity Accounting, to gather sufficient appropriate audit evidence to form an opinion on the supplementary equity information relating to the auditee's investment in an associated company.

In order to form an opinion on the fair presentation of the equity financial information, the principal auditor would need to use the associated company's financial statements. In addition, the auditor would normally need to evaluate the professional competence of the investee company auditor and obtain representations from that auditor as to the investee's compliance with applicable accounting, auditing and reporting standards. The principal auditor would also be required to obtain reasonable assurance that the work performed by the other auditor is adequate for the principal auditor's purpose. This assurance might be obtained by way of discussions with the other auditor of the audit procedures applied or review of the other auditor's working papers.

The relevance of equity accounting to public sector entities is minimal given that AAS 14 and ASRB 1016 do not apply to non-corporate entities and have not been incorporated into the various Annual Reporting Regulations.
Even if supplementary financial information was included in the investor's financial statements, the Auditor-General would be severely restricted in relation to the audit procedures performed as he would not have any statutory right of access to the accounting and other records of the associated company.

Where the Government intends to either sell down its interest in an entity to a minority position or acquire a minority interest, it will be necessary to make a decision regarding the controls or monitoring mechanisms that the State requires in order to ensure that its interest is adequately protected. The decision is likely to depend on the significance of the State’s financial exposure. Consideration may also need to be given to any social impact or possible adverse impact on the business sector. There will obviously be a trade-off between the amount that a private sector buyer will be willing to pay for a public sector entity and the level of government regulation that is acceptable to the buyer. The Government, however, may be able to negotiate one or more of the following terms, for example, into the sales or purchase agreement:

- that the Auditor-General retain or gain responsibility for the external audit of the entity;

- that the State has representation on the board of directors;

- that regular interim reports be provided to the central agency which is responsible for monitoring the Government's interest in the entity;

- that the State has representation on the audit committee; and/or

- that the Auditor-General and/or the relevant central agency have access to the internal audit working papers and/or the accounting records.

In principle it is unlikely that a private sector buyer would accept a requirement that the Auditor-General be retained as the external auditor. Accordingly, the Government will need to ensure that other mechanisms are in place which will provide reasonable assurance that the State's interest is adequately protected. It would then be the Auditor-General's responsibility to evaluate the adequacy of the processes that the central or other government agencies have put in place to monitor and safeguard the Government's interest in the entity.
The following comments were provided by Mr Fergus Ryan in relation to the Auditor-General's right of access and approach for entities in which the public sector has a minority holding:

"The basic principle that is relevant here is, I believe, that the Auditor-General's consideration of the investment of public funds in private-sector controlled ventures needs to be focused not directly on the ventures themselves, but rather on the mechanisms which should be in place within the public sector entity which is responsible for monitoring that investment of public funds. To repeat an earlier theme, the primary responsibility for evaluating whether public sector funds applied to a private sector venture are secure and are being utilised effectively lies not with the Auditor-General, but within the public sector. The concern of the Auditor-General should be with whether the responsible public entity is in fact undertaking its monitoring and evaluation responsibilities effectively.

As a practical matter, I think it is clear that where the Government either sells down its interest in an entity to a minority position or acquires a minority interest, it is highly unlikely that the private sector majority interests will accept a Government prerogative to retain the Auditor-General as external auditor.

It may of course be possible that an arrangement for a right of access by either the responsible public sector entity or, perhaps, the Auditor-General, could be negotiated in specific circumstances. This would appear to be more in the nature of a policy decision concerning the terms upon which the public sector is prepared to commit funds to private sector ventures." (F. Ryan, 27/8/93)

It should be pointed out that an evaluation, by the Auditor-General, of the processes that the public sector has put in place to monitor the State's interest in an investee entity, will not ensure that the Auditor-General is able to identify all existing problems within that entity. The Royal Commission into the Tricontinental Group of Companies, concluded that the central agencies, public servants and ministers who were responsible for administering, supervising and monitoring the Government's one hundred percent interest in the State Bank of Victoria and its wholly owned Tricontinental subsidiary, had performed their duties responsibly and properly.\textsuperscript{19} The monitoring mechanisms which included the receipt of detailed reports of the State Bank, regular meetings with the board chairman and chief

executive officer and representation on the State Bank's board of directors, were considered, by the Commission, to be adequate even though they were ineffective in identifying potential and existing problems.

Finding 4.2

When the public sector acquires a minority interest in an entity, it has a responsibility to ensure that there are adequate processes in place to monitor and safeguard its interest in that entity. The significance of the State's exposure will determine the nature and extent of those processes. As indicated by the collapse of the Tricontinental Group of Companies, State monitoring mechanisms will not necessarily ensure that all problems, within the entity, are identified.

Recommendation 4.3

The Auditor-General should review and evaluate the adequacy of the processes that the central or other agencies put in place to monitor and safeguard minority public sector holdings in private sector entities.

4.5 ENTITIES IN WHICH THE STATE HAS NO EQUITY INTEREST

State monies may be provided to non-government entities to enable these entities to provide various services to the community. Arrangements of this type would include the annual grants which are provided to non-government schools and grants and subsidies to voluntary groups and institutions which render welfare and correctional services to the community.

The government departments which are responsible for administering specific programs have a duty to ensure that funds allocated to external organisations are spent for the purposes provided. Where grants and subsidies are provided, for example, to voluntary organisations through the Department of Health and Community Services, that Department has a responsibility to ensure that payments are subject to pre-determined terms and conditions and that the organisation receiving the funds has complied with those terms and conditions. Monitoring and control mechanisms put in place by Departmental management might require, for example, that the payee organisation:
• submit interim (eg. annual, quarterly) audited and/or unaudited reports to the Department;

• provide authority for Departmental staff to inspect or audit their books and accounts; and/or

• submit documented evidence (in the form of supplier invoices, receipts, etc.) to the Department as proof of expenditure.

It is management’s responsibility to ensure that processes have been put in place to provide reasonable assurance that monies allocated to non-government institutions and groups have been utilised for the purposes provided. It is the auditor’s responsibility to assess the adequacy of these processes and report on any deficiencies. The basic premise underlying this is that the accountability process is not only relevant in cases where State monies are directly involved in public sector operations, it is also relevant where public monies are allocated to non-government organisations for the provision of community services.

Similarly there is a need for accountability where a contingent liability exists in respect of non-government operations. This might occur, for example, where the Treasurer provides a guarantee or indemnity to an organisation in which the government has no equity interest. Existing arrangements of this type include:

• a Treasurer’s guarantee in relation to Melbourne Cricket Club borrowings to enable the Club to finance the construction of the Southern stand ($153 million);

• a Treasurer’s indemnity to bondholders under the Accelerated Infrastructure program (for the financing of government accommodation to be obtained from the private sector) should the leasing company, Property Leasing Ltd, default on payments to bondholders ($275 million); and

• Treasurer’s guarantees and indemnities to bondholders and trustees which were issued under the provisions of the Health Services Act 1988 in relation to
the financing of the St. Vincent's Hospital redevelopment ($80 million).\textsuperscript{20}

These contingent liabilities represent a financial exposure to the State with future obligations (if any) dependent upon the occurrence of future events or outcomes.

Where the public sector enters into an arrangement which results in a financial exposure, to the State, in relation to the activities of a private sector entity, it is incumbent upon the public sector to ensure that contractual arrangements include terms and conditions which will allow the public sector to adequately monitor this exposure. Further, if the public sector bears the majority or all of the financial risks, it is arguable that the terms and conditions should include a requirement that the Auditor-General be the appointed auditor or at a minimum, have access to the private sector entity's accounting records.

The Auditor-General, in his 1992/93 Report on the Finance Statement, pointed out that his previous Reports on the Finance Statement have commented on deficiencies in the Department of Treasury's processes for recording and managing the State's contingent liabilities. He further stated that due to inadequate action to improve the completeness of the Department's records, he was unable to provide assurances to the Parliament as to the full extent of the State's contingent liabilities as at 30 June, 1993.\textsuperscript{21} The Committee recently heard evidence which also suggests that all of the State's contingent liabilities might not be readily identifiable from Departmental records, and is currently undertaking an Inquiry into this matter. The existing deficiencies, in the Committee's view, further highlight the need for additional involvement, by the Auditor-General.

\begin{boxedquote}
Finding 4.3

The public accountability process is not only important in cases where State monies are directly involved in a venture, it is also important where the State acquires a financial risk in respect of certain private sector activities through the issue of government guarantees, indemnities or other undertakings.
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\textsuperscript{20} Finance Statement 1992-93 for the Year Ended 30 June 1993 and the Report of the Auditor-General, Part A, L.V. North, Government Printer, Melbourne, 1993, pages 138-140. The amounts disclosed represent "gross" (or maximum) liabilities as at 30 June 1993 and do not recognise the likelihood of any call on the guarantees and indemnities. Nor are offsetting contingent assets taken into account. Accordingly, "net" contingent liabilities may be less.

\textsuperscript{21} Ibid., Part B, page 98.
Finding 4.4

Where the public sector has a financial risk in relation to the activities of an entity in which the State has no equity interest:

a) it is incumbent upon the public sector to ensure that it has adequate procedures in place to monitor its exposure; and

b) the Auditor-General should review and evaluate the adequacy of the processes that the central or other government agencies have put in place to monitor this risk.

Recommendation 4.4

Where the public sector bears a significant risk in respect of the activities of an entity which is wholly owned by the private sector, the terms and conditions of the arrangement should include a requirement that the Auditor-General be the appointed auditor, or at a minimum, have access to the accounts and records of the private sector entity.
CHAPTER FIVE: AUDITOR-GENERAL'S RELATIONSHIP WITH PARLIAMENT AND THE EXECUTIVE

5.1 APPOINTMENT OF THE AUDITOR-GENERAL

Section 4(1) of the Audit Act 1958 states that the Auditor-General shall be appointed by the Governor in Council. The Act does not specify who should make the recommendation for appointment. In practice, the Auditor-General is appointed by the Governor in Council on the recommendation of the Premier. Parliament has no role in the appointment process.

Mr Fergus Ryan, in his Report, expressed the view that:

"This appointment process is inconsistent with the fundamental role which the Auditor-General plays in the accountability of the Executive to Parliament. The Auditor-General reports to Parliament, not to the Executive, and the Executive in principle has no power over, or responsibility for, the Auditor-General." ¹

It was recommended that the Auditor-General be appointed on the nomination of Parliament and not of the executive. Mr Ryan suggested that the Economic and Budget Review Committee would appear to be an appropriate body to make a nomination.² The Economic and Budget Review Committee has since been replaced by the Public Accounts and Estimates Committee which performs a similar function to the previous committee.

The practice of appointing an Auditor-General solely on the recommendation of an executive contrasts with the approach taken in places such as Britain, New Zealand and Canada where Parliaments are reported to play a role in the selection process. It also contrasts with the recommendations of various Parliamentary committees within Australia, who have generally agreed that Parliament should have a greater role in the appointment process.

The New South Wales Public Accounts Committee, in a 1990 report, recommended the establishment of a five member, legislative assembly selection committee.

² Ibid.
responsible for examining applications for the position of Auditor-General and communicating a recommendation to the Parliament, which in turn, would make a final recommendation to the Governor.\textsuperscript{3}

The Public Accounts and Expenditure Review Committee of the Parliament of Western Australia, in its 1992 report, recommended that it perform the duties associated with the selection of an Auditor-General and have responsibility for recommending a short list of suitable applicants to the Premier.\textsuperscript{4}

The Queensland Electoral and Administrative Review Commission, in a 1991 report, recommended that legislation be amended to require the Auditor-General's appointment to be approved by the Public Accounts Committee (or a majority of that Committee other than a majority consisting wholly of government Members).\textsuperscript{5}

This Committee supports the view expressed by Mr Fergus Ryan and the general thrust of the recommendations of the various Parliamentary committees. The recommendation of the Auditor-General's appointment by the executive, is a less than optimal approach, in the Committee's view, because it is inconsistent with current thinking and it exposes the executive to claims that it has appointed a person who possesses political bias or who is seen to be incapable or less than independent.

At public hearing, the Victorian Auditor-General, Mr Ches Baragwanath expressed the following opinion on the appointment process:

"Unless there is some truly Parliamentary representative committee involved in the selection process the executive government could leave itself open to the accusation that it is another job for the boys. That puts both the Auditor-General and the government in an awkward situation." \textsuperscript{6}

In recent years, some of the Auditor-General's reports have received a considerable amount of publicity and this, at times, has caused embarrassment to the government of the day. In view of this, it is possible that an executive, in recommending the


\textsuperscript{6} Minutes of Evidence, 1 September 1993, page 10.
appointment of an Auditor-General, might be tempted to recommend someone who it is perceived will cause the least problems rather than someone who will perform the job effectively.

The Public Accounts and Estimates Committee has the ability to inquire into matters referred to it by Parliament or the Government and may also undertake inquiries on its own initiative. Due to the nature of the Committee's work, much of its time is devoted to investigating matters raised in the Auditor-General's reports to Parliament. The inquiry process, by necessity, involves an evaluation and assessment of the Auditor-General's findings and recommendations.

Should this Committee take part in the appointment of the Auditor-General, members would also later be faced with conducting inquiries into matters raised by that person. There is validity to the premise that the Committee should not be placed in a position that leaves it open to the accusation that it has a vested interest in justifying a previous decision - i.e. the selection of an Auditor-General. The Committee's important role within the State's accountability framework requires that there are no perceived or real doubts about the objectivity of Committee inquiries arising from the Auditor-General's reports.

The risk of any actual or perceived conflict of interest is significantly reduced, however, because the Committee's recommendations for the appointment of an Auditor-General would be subject to the Parliament's review. This potential conflict is further minimised given that Auditors-General are appointed at relatively infrequent intervals when compared with changes in the composition of the Committee. The Committee's knowledge of the Auditor-General's work also ensures that it is well placed to undertake a role in the selection process.

Alternative arrangements would probably necessitate the establishment of a separate committee. This has disadvantages because it is administratively more complex and that committee might also lack the required knowledge and understanding of the Auditor-General's responsibilities and functions.

The Committee supports the premise that a Parliamentary committee should be involved in the Auditor-General selection process, and after taking into consideration the advantages and disadvantages, has formed the opinion that the Public Accounts and Estimates Committee is best placed to perform this function.
Finding 5.1

The appointment of the Auditor-General, on the recommendation of an executive, is inconsistent with the Auditor-General's role in ensuring the accountability of the executive to the Parliament.

Finding 5.2

The Public Accounts and Estimates Committee's knowledge and understanding of the Auditor-General's role ensures that the Committee is well placed to undertake the duties associated with the selection of an Auditor-General.

Recommendation 5.1

The Public Accounts and Estimates Committee (or its successor) should be responsible for making a recommendation to the Parliament concerning the appointment of the Auditor-General.

Recommendation 5.2

The Auditor-General should be appointed by the Governor in Council on the nomination of the Parliament.

5.2 FUNDING OF THE OFFICE

Existing arrangements

The Audit Office is funded through the normal budgetary processes that apply to all budget sector entities. For administrative purposes, the Audit Office is funded as a separate program under the Department of the Premier and Cabinet. The Auditor-General's salary is funded directly by Parliament via a specific appropriation.

The Treasurer, in explaining the budgetary processes at public hearing, stated that government departments are required to submit their spending proposals in the form of budgets to the Budget and Expenditure Review Subcommittee of Cabinet. Treasury makes recommendations to the Budget and Expenditure Review Subcommittee which, in turn, makes recommendations to the Cabinet that
determine the overall allocations to individual departments for both recurrent and capital expenditure. The way in which payments are distributed within a department is a matter for the department, subject to review by the Budget and Expenditure Review Subcommittee.7

Mr Fergus Ryan’s recommendations

Mr Fergus Ryan, in his report, expressed the view that the involvement of the executive in the process of approval of the Audit Office’s budget is inconsistent with the concept of the Auditor-General’s role in the accountability of the executive to Parliament. Mr Ryan noted that there exists a clear risk, in theory, that the effectiveness of the Auditor-General could be constrained by an executive which chose to deny adequate funding.8

It was recommended that Parliament should approve the budget of the Audit Office and should fund the Office directly by way of a specific appropriation.9 Mr Ryan stated that the Economic and Budget Review Committee of the Parliament would appear to be an appropriate mechanism through which Parliament could undertake the review of the Office’s budget.10

Concept of audit independence

The concept of independence is fundamental to the auditing profession. Statement of Auditing Standards AUS 1 states:

"Auditors shall be straightforward, honest and sincere in their approach to their professional work. They must be fair and must not allow prejudice or bias to overrule their objectivity. They shall maintain an impartial attitude and both be, and appear to be, free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity."11

Audit objectivity is not possible if the auditor is susceptible to undue influence or pressure or has a personal interest in the outcome of the audit. The credibility of the

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8  Ryan, F., op. cit., page 15.
9  Ibid.
10 Ibid.
11 Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, Statement of Auditing Standards AUS 1, paragraph 16.
auditor and hence the value of the independent audit lies with the fact that the auditor is, and is seen to be, independent of the entity being audited.

The Australian Society of Certified Practising Accountant's Code of Professional Conduct warns private practitioners to carefully consider their position where the fees from an individual client, or relevant group of clients, represent the only income or a substantial portion of the income of the practice, because their independence will inevitably come under scrutiny and raise doubts as to objectivity.12

The Commonwealth Joint Committee of Public Accounts criticised the Commonwealth Auditor-General in 1989 for never having conducted a performance audit of the Department of Finance despite that Department's centrality to the Government's operations, the potential large savings to the Government and the possibility of improved public sector effectiveness. The Committee also acknowledged, however, that there could be an unacceptable level of strain on the Audit Office if it subjected the organisation which recommended its budget to intensive and prolonged scrutiny.13

Total independence may not be attainable in the private sector because many auditors are effectively paid and appointed by company directors rather than by owners or shareholders. There is the potential for greater audit objectivity in the public sector, however, because public sector managers do not have to control the Auditor-General's funding or appointment. The Commonwealth Senate Standing Committee expressed the view that it may be unavoidable that management has a dominant say in the choice of auditor in the private sector and, in that case, the auditor may become close to management. This is not inevitable in the public sector.14

As long as the executive assumes a responsibility for reviewing and approving the Audit Office's budget, audit objectivity may be questioned and the executive vulnerable to the criticism that it may be trying to restrict the Auditor-General's activities by limiting his budget.

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Under section 17 of the Public Sector Management Act 1992, the Auditor-General performs the functions and has the powers of a department head. Notwithstanding this, the appropriation of the Auditor-General’s Office and the appropriations of other statutory officials such as the Ombudsman, come under the Department of the Premier and Cabinet.

Under the existing budgetary arrangements, the Auditor-General’s budget is incorporated into the Department of the Premier and Cabinet’s budget and submitted to the Budget and Expenditure Review Subcommittee of the Cabinet. The Auditor-General may therefore not have the same opportunity as do other department heads, to justify proposed expenditures to the Subcommittee.

The existing arrangement is deficient because it leaves the head of the Department of the Premier and Cabinet open to the criticism that attempts could be made to increase that Department’s funding at the expense of the Auditor-General’s program and those of other statutory offices. Such an approach might ensure that the Department of the Premier and Cabinet’s overall budget is retained at an acceptable level.

Conclusion

The Western Australian Public Accounts and Expenditure Review Committee in 1992 recommended that the Parliament should take the initiative in determining the budget for the Office of the Auditor-General separate of executive government and central agencies in order to ensure the independence of the Auditor-General and his Office.15

The Commonwealth Joint Committee of Public Accounts, in 1989, expressed the view that the executive should not have sole responsibility for advising on the Australian Audit Office’s appropriations, but instead, should share that responsibility with the Parliament. It was recommended that a Parliamentary committee be established to consider the Audit Office’s finances and that the Minister of Finance be included on that committee in order to ensure that the Office’s bid for resources would be subject to the same level of scrutiny as are other departments. It was further recommended that the Australian Audit Office’s

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estimates be included in the Appropriation (Parliamentary Departments) Bill and considered by a Senate Estimates Committee in the usual way.\textsuperscript{16}

More recently, the Victorian Commission of Audit recommended that the Auditor-General's Office should be funded through a Special Appropriation under the control of a Parliamentary committee chaired by the Speaker.\textsuperscript{17}

One of the Public Accounts and Estimates Committee's functions is to scrutinise the Annual Budget Estimates and to report its findings to the Parliament. In view of the Committee's Budget Estimates function, it is considered inappropriate that this Committee also be involved in the review and setting of the Audit Office's budget.

Further, the Committee in section 3.3 of this report, has recommended that it should be able to suggest possible performance audit subjects but should not have the ability to direct the Auditor-General to undertake these audits. Involvement of the Committee in setting the Audit Office's budget may place unintended pressure on the Auditor-General to undertake recommended audits. This in turn, could undermine the independence and/or perceived independence of both the Auditor-General and this Committee.

The Commonwealth Joint Committee of Public Accounts and the New South Wales Public Accounts Committee recommended that the budgets of their respective Audit Offices be determined on the basis of a pre-determined formula and linked to growth in the income and expenditure of the public sector. This type of arrangement would ensure impartiality.

The Committee, however, is of the view, that the Government's overall budgetary strategies should be taken into consideration in determining the Audit Office's budget, and that a funding method which was based on a pre-determined formula, would not adequately achieve this objective.

At public hearing the Treasurer expressed the following opinion when questioned on the Audit Office's budget:


\textsuperscript{17} Report of the Victorian Commission of Audit, Volume One, Graphic Print Centre, Melbourne, May 1993, page 209
"It is my view that no element of government funded out of the public purse that does not have a dedicated revenue source can be exempt from the overall parameters of the Budget. It could not be acceptable to any government, and probably not acceptable to the opposition, for the Parliament to determine a large increase in outlays at a time when the government is imposing expenditure restraint across the public sector as a whole."\textsuperscript{18}

While the Committee supports the view that Parliament should have a greater role in determining the Audit Office's budget, members are also of the opinion that the Treasurer should be represented on any Parliamentary Committee which has been established for this purpose.

\begin{center}
\textbf{Finding 5.3}
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A Parliamentary committee, with due recognition of the Government's overall budgetary strategies, should have a role in determining the Audit Office's budget.

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\textbf{Finding 5.4}
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Review of the Audit Office's budget by the Public Accounts and Estimates Committee, would be incompatible with some of the Committee's other activities, including its role in scrutinising the Annual Budget Estimates, reviewing the Audit Office's output and recommending possible performance audit subjects.

\textsuperscript{18} Minutes of Evidence, 17 September 1993, page 26.
Recommendation 5.3

It is recommended that:

(a) a seven member Parliamentary committee be established to review the Audit Office's budget proposals and make a recommendation to the Parliament;

(b) this committee should comprise the Speaker of the Legislative Assembly or President of the Legislative Council who should alternate on an annual basis;

(c) the composition of the remainder of the committee should ensure an equal representation of Government and Opposition members and should include the Treasurer (or his Parliamentary representative) and the Chairman and one other member of the Public Accounts and Estimates Committee; and

(d) the Speaker and President should alternate as Chairperson on an annual basis.

Recommendation 5.4

The proposed committee's role in setting the Auditor-General's budget should, in no way, impact upon the Auditor-General's ability to determine the application of audit resources or lead to a review of the merit, or otherwise, of particular performance audit proposals. Performance audits should therefore be funded on a total, annual basis rather than on an individual basis.

5.3 RELATIONSHIP WITH PARLIAMENT

Mr Fergus Ryan noted that the flow of communication from the Parliament to the Auditor-General could be improved and suggested that enhanced communication could potentially better enable the Auditor-General to understand and therefore meet the needs and expectations of his client, the Parliament.19

It was recommended that the Economic and Budget Review Committee or another
designee of the Parliament:

- actively participate in the development of the Audit Office's objectives or at
  a minimum endorse these objectives,

- participate in the development of the Audit Office's annual performance
  audit plan.\(^{20}\)

Details of the Committee's views and recommendations on the development of the
Audit Office's annual performance audit plan are contained in section 3.3.4 of this
report.

The Committee supports the recommendation that a Parliamentary committee
participate in the formulation of the Audit Office's objectives and believes that the
Public Accounts and Estimates Committee should undertake this role because of its
understanding of the Audit Office's functions. The Auditor-General has stated at
public hearing that he sees himself as Parliament's auditor but is not too sure of
what the Parliament wants.\(^{21}\) Participation by the Public Accounts and Estimates
Committee, in the formulation of the Audit Office's mission and strategic directions,
could therefore assist the Auditor-General in clarifying the needs and expectations
of the Parliament, thereby contributing to the Auditor-General's effectiveness.

Recommendation 5.5

The Audit Office's objectives should be reviewed jointly by the Public Accounts
and Estimates Committee and the Auditor-General, on an annual basis.

Recommendation 5.6

The Committee should endorse the adoption, by the Audit Office, of the agreed
objectives.

\(^{20}\) Ibid., page 16.
\(^{21}\) Minutes of Evidence, 1 September 1992, page 22.
Recommendation 5.7

The Audit Office should include the endorsed objectives in its annual report so that Parliament is informed of those objectives.
6.1 AUDIT METHODOLOGY AND APPROACH

6.1.1 Mr Fergus Ryan’s Findings and Recommendations

Mr Fergus Ryan concluded that the Audit Office’s financial audit methodology is consistent with current audit thinking and complies with Australian auditing standards.\(^1\) He also indicated that he had reviewed a sample of financial audits which had been conducted by the Office and had not identified any examples of inappropriate overall conclusions.\(^2\) Notwithstanding this, it was suggested that some aspects of financial audits could be improved.

In evaluating compliance with Australian accounting standards and best practice, Mr Ryan stated that it was necessary to acknowledge that most of the issues raised in his report, in respect to financial audits, are complex and judgemental matters and that practices are still evolving in the audit profession as a whole. It was further acknowledged that the issues raised in the report related primarily to 1990-91 audit engagements and that because this was the year in which a new audit methodology (that is the Enhanced Financial Audit Methodology or EFAM) was first utilised within the Audit Office, the issues would need to be evaluated in this context.\(^3\)

Mr Ryan expressed the view that he has no doubts that the Audit Office is moving in the right direction and that inevitably such a migration will not be fully achieved in the first year of change.\(^4\) Findings along with recommendations for improvements are summarised as follows:

*Sampling techniques*

It was noted by Mr Ryan that the Audit Office was not complying with Australian Auditing Practice Statement AUP 24 or best practice in its approach to selecting

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\(^2\) Ibid., page 34.

\(^3\) Ibid., page 31.

\(^4\) Ibid., page 32.
sampling methodology, determining sample sizes or evaluating the results of sampling.

It was recommended that the Office upgrade the documentation of sampling methodology in EFAM and conduct comprehensive training programs in sampling methodology for all financial auditing staff.5

*Audit scopes and materiality levels*

Mr Ryan found that the EFAM manual’s guidance on materiality and scope setting was fairly brief and working papers generally contained no documentation on either the materiality level that had been set or the means by which it had been determined.

In order to ensure compliance with Statement of Auditing Practice AUP 27 - Materiality and Audit Risk, it was recommended that the process of determining and documenting materiality be covered in more detail in the EFAM manual and in audit working papers.6

*Integration of EDP risk evaluation into the audit process*

Mr Ryan noted that in a number of instances, an information technology control evaluation had been undertaken but the results of that evaluation had not been reflected in the subsequent audit work performed.

It was suggested that the Audit Office review its approach to financial audits to ensure that information technology reviews are performed early in the audit process and the conclusions appropriately integrated into audit plans.7

*Clearer identification of linkages between risk evaluation and audit approach*

In a number of engagements, Mr Ryan found that the linkage between the planning process and the work performed was not clearly documented.

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5 Ibid.
6 Ibid.
7 Ibid., pages 32 and 33.
This problem was primarily attributed to the implementation and initial use of the new EFAM audit methodology and was expected to be identified in the peer review process and appropriately actioned.\(^8\)

*Post-balance date review*

Mr Ryan noted that the EFAM manual did not address post-balance date review and that there was a considerable variation in the nature and extent of post-balance date review procedures performed by staff.

It was recommended that minimum post-balance date procedures be specified in the EFAM manual and a checklist developed and utilised to ensure the adequacy of these procedures.\(^9\)

*Use of internal audit*

Very few instances of reliance on the work performed by internal audit were identified although there were indications that internal audit had performed work which may have been relevant. Mr Ryan also found that the status and quality of public sector internal audit is very inconsistent.

It was suggested that the Office seek out opportunities to make use of the work of internal audit.\(^10\)

**6.1.2 Conclusion**

In response to a Committee questionnaire, the Auditor-General has stated that the Office had already initiated strategies to deal with the majority of these issues as a result of the Audit Office's review of the initial use of EFAM in early 1992.\(^11\)

The Committee believes that the implementation of Mr Ryan's recommendations could potentially enhance the efficiency and effectiveness of the Audit Office's financial audits by ensuring that the Office utilises audit procedures which contribute to an informed and timely audit opinion at a minimum cost.

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8. Ibid., page 33.
9. Ibid.
10. Ibid., page 34.
Finding 6.1

The auditor who is selected to undertake the next performance audit of the Audit Office will be directed by the Committee to follow up each of the matters raised by Mr Ryan, in respect of financial audits, in order to ensure that all issues have been satisfactorily resolved.

6.2 TIMING OF FINANCIAL AUDITS

Mr Ryan noted that the Office compresses the time frame of the complete financial audit process into a period commencing shortly before balance date and ending prior to audit sign off date (usually late October) and that the planning stage of many audits does not commence until June.12

It was recommended that the planning phase of the financial audit process be brought forward significantly in order to enable the Office to make full use of its risk based audit methodology (including undertaking interim testing where appropriate). It was suggested that this would provide opportunities for savings in overall audit time by reducing the need for substantial amounts of year end verification work and by identifying issues at an early stage which could be rectified in co-operation with the auditee.13

In addition, Mr Ryan suggested that earlier commencement of audit planning would address some of the significant concerns expressed by auditees. These concerns primarily related to the absence of identification and discussion of issues until very near to the date of finalisation of audited financial statements and the hindering of the auditee's ability to properly plan for the audit.14

At public hearing on 1 September 1993, the Auditor-General indicated that the planning phase of financial audits for major auditees had been brought forward. The Auditor-General also stated that some of the auditees are so small that to do an interim and final audit would be a waste of time and resources.15 The Committee accepts that it may not always be practical or appropriate to perform interim audit procedures as in the case, for example, of a very small auditee.

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12 Ryan, F., op. cit., page 35.
13 Ibid.
14 Ibid.
15 Minutes of Evidence, 1 September 1993.
Submissions received by the Committee from a sample of the Auditor-General's auditees indicate that some small to medium sized auditees are concerned about the late planning and conduct of financial audits.

Notwithstanding that the Parliament is the Auditor-General's client, the Committee believes it appropriate that the Auditor-General attempts to resolve any legitimate concerns expressed by his auditees in order to facilitate a co-operative relationship with auditee management and enhance the overall audit process.

Finding 6.2

The Committee will monitor, on an ongoing basis, the progress made by the Auditor-General in resolving auditee concerns on the timing of financial audits.
7.1 MR RYAN'S OVERALL CONCLUSIONS

Mr Ryan formed the opinion that the Audit Office's performance audit methodology is advanced in development by world standards and its application to specific engagements generally of a high standard. Having acknowledged that the Audit Office's performance audit methodology was still being implemented at the time of Mr Ryan's review, it was suggested that some aspects of performance audits could be enhanced.

7.2 PEER REVIEW

It was noted, by Mr Ryan, that no process comparable to the Audit Office's financial audit peer review unit had been established to evaluate the Audit Office's performance audit methodology (VPAM or Victorian Performance Audit Methodology). It was recommended that a performance audit peer review process be established.

The Audit Office has advised the Committee that a peer review of performance audits has been completed and that future reviews will be undertaken on an annual basis.

7.3 SELECTION OF PERFORMANCE AUDITS

Audit subjects in the Audit Office's performance audit plan are ranked according to potential estimated benefits which are expected to flow from the audits. Subjects are focused on the operations of specific auditees as distinct from common issues across a range of auditees.

It was suggested, by Mr Ryan, that the effectiveness of the ranking process and the resulting output could be significantly improved if:

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2. Ibid., page 37.
3. Ibid.
4. Ibid., page 4.
• more performance audits were selected on their importance to the public sector as a whole as distinct from their importance to a particular entity or part of an entity;

• some audits were undertaken with a view to identifying best practice; and

• auditees were notified of potential performance audit subjects.

Selection on the basis of importance to the public sector as a whole

A discussion of the Committee's views, along with its findings and recommendations, in relation to the selection of performance audits, is provided in chapter 3 of this report.

Identification of best practice

It would seem that the Audit Office has acted upon the recommendation that some audits be undertaken with a view to identifying best practice. The Office is currently conducting a performance audit of investments and has advised the Committee that the Transport Accident Commission has been included in the review for the purpose of identifying best practice.

Notification of potential performance audit subjects

Mr Ryan noted that the Audit Office's Master Audit Plan (MAP) lists 2,000 potential performance audit subjects. It was suggested that notifying auditees of potential audits might result in earlier realisation of benefits.5

Benefits derived from advising auditees of potential performance audits are likely to be maximised if auditees are notified of a small number of key subjects which, in the Auditor-General's view, represent the greatest risk or will provide the greatest potential benefits and/or cost savings. This approach will ensure that action taken, to improve existing systems, is concentrated on the most significant or critical areas and that auditee managers are not deterred from acting upon the Auditor-General's suggestions due to the difficulties associated with addressing a large number of issues.

5 Ibid., page 39.
In order to avoid possible misunderstandings, auditees should be clearly advised that the audits are potential rather than planned, and may be subject to change.

Finding 7.1

The Committee concurs with Mr Ryan's opinion that notification of potential performance audits, by the Audit Office, might result in earlier realisation of benefits.

Finding 7.2

In order to ensure that action taken by auditees to improve existing systems is concentrated on critical operational areas, auditees should be advised of a manageable number of significant potential performance audit subjects from the Audit Office's Master Audit Plan.

Recommendation 7.1

Where appropriate, auditees should be advised, on an annual basis, of those potential performance audits which, in the Auditor-General's view, are likely to provide significant benefits and/or cost savings given prevailing conditions.

7.4 POLICY OBJECTIVES

Mr Ryan concluded that a significant proportion of the criticism of performance audit reports relates to issues of government policy. After reviewing two of the Auditor-General's performance audit reports it was concluded that the Auditor-General did not contravene section 48A(6) of the Audit Act 1958 which precludes the Auditor-General from questioning the merits of policy objections of the Government.

While it was acknowledged that the potential for dispute over the interpretation of section 48A(6) will never be entirely eliminated, Mr Ryan suggested that it would be helpful if the Auditor-General produced, and Parliament endorsed, a document

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6 Ibid., page 40.
7 Ibid., page 41.
which sets out the manner in which section 48A(6) will be interpreted and applied in future performance audits.\(^8\)

Section 48A(6) of the *Audit Act* 1958 is open to broad interpretation and it is considered that any attempt to define or explain its interpretation or application would also need to be broad. For this reason, it is considered unlikely that any significant benefits would be derived from the preparation of an explanatory document. The identification of what comprises government policy, by its nature, is something which is best done on a case by case basis.

### 7.5 IDENTIFICATION OF PERFORMANCE AUDIT MEASURES

It was noted by Mr Ryan, that the knowledge acquired from performance audits, including details on the development of performance audit measures or benchmarks, is not held in a central, accessible location within the Audit Office.\(^9\)

It was recommended that at the end of each audit a memorandum should be prepared. The memorandum should outline the audit and significant issues which arose including development of performance audit measures, use of experts and other matters. It was also suggested that an exchange of information occur at a national level in order to add to the effectiveness of all Auditors-General.\(^10\)

The Committee supports the premise that the knowledge acquired from performance audits should be readily accessible to all Audit Office staff as well as to other Auditors-General.

The Audit Office has advised the Committee that there is total co-operation between the various Audit Offices and that performance audit plans and other information are made available on request.

### 7.6 REPORTING OF PERFORMANCE AUDITS

It was concluded, by Mr Ryan, that the presentation of audit reports is of a very high standard in world terms and that reports are well laid out and are clearly and concisely written and illustrated.\(^11\) Mr Ryan also expressed the view that it is

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8. Ibid.
9. Ibid., page 42.
10. Ibid.
11. Ibid., page 43
important that the Office be given credit for the progress which it has made in performance audit reporting and stated that the Office is at the leading edge by world standards.\textsuperscript{12} It was noted that while reports are well received by most users, they do however, generate considerable friction with auditees arising primarily from the criticism that there is a lack of balance in the reports.\textsuperscript{13}

Mr Ryan recommended continued enhancements in the preparation and presentation of performance audit reports including:

- developing an improved style of executive summary in order to convey the objectives (including a clear articulation of policy constraints), significant conclusions and significant recommendations of the audit in a more balanced manner;\textsuperscript{14} and

- developing recommendations to either address identified problems or prevent their recurrence.\textsuperscript{15}

\textit{Developing an improved style of executive summary}

The Committee reviewed a sample of the Auditor-General's special (performance audit) reports in order to determine whether or not the Auditor-General had adopted a more balanced reporting style as recommended by Mr Ryan. The following reports were examined by the Committee:

- Bayside Development, May 1992;
- Visiting Medical Officer Arrangements, April 1993; and
- Aged Care, September 1993;

The review revealed that changes have occurred in the way in which findings and conclusions are reported in both the executive summary and within the body of the reports.

\textsuperscript{12} Ibid.
\textsuperscript{13} Ibid., pages 43 & 44.
\textsuperscript{14} Ibid., page 4.
\textsuperscript{15} Ibid.
The special report on Aged Care is one of the most recent of the Auditor-General’s reports. The Executive Summary contains positive comments, for example, in relation to those areas of aged care which were considered, by audit, to be of a high standard. It also acknowledges recent and proposed Departmental and Government initiatives which have been formulated to improve aged care services. The approach adopted contrasts with that of the earlier three reports where executive summaries primarily contained negative and informational or explanatory comments.

The Executive Summary in the Aged Care report, is also more balanced in that it contains a statement to the effect that the summary of major audit findings should be considered in the totality of the discussion in the report. Another initiative is the inclusion of overall management responses within executive summaries. The report on Aged Care and the report on Visiting Medical Officer (VMO) Arrangements each contain an overall response by the Secretary to the Department of Health and Community Services. The earlier two reports provide management responses on specific issues within the reports, but do not contain overall management responses.

Comments relating to positive aspects of the audit have been made throughout the Aged Care report. Management initiatives to address deficiencies have been recognised and actions by specific service providers acknowledged. Prior audit reports, in contrast, have tended to be based on the concept of ‘reporting by exception’. With this method of reporting, any problem identified by the auditor is reported, so that the absence of a specific reference to any matter which falls within the scope of the audit, would mean that the auditor did not identify any significant problem in that area. When questioned at public hearing on the availability of a suitable, comparable system to control hospital payments to VMOs, the Auditor-General stated that the Monash Medical Centre in particular, might serve as an appropriate model.16 The Auditor-General’s special report on Visiting Medical Officer Arrangements, however, did not acknowledge this.

The Committee supports the premise that the Auditor-General’s reports should be presented in a balanced manner and this obviously involves the reporting of positive audit findings as well as negative. It is not proposed, however, that the Auditor-General should attempt to make positive comments in relation to areas containing significant deficiencies or that recognition be given to management initiatives unless there is reason to believe that this recognition is justified.

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16 Minutes of Evidence, 1 September 1993, page 19.
The Auditor-General's recent special report on Aged Care indicates that there has been a significant move towards more balanced reporting by the Audit Office. The Auditor-General and his senior officers are to be commended for the progress made in this area.

*Developing recommendations to address deficiencies identified by audit*

Mr Ryan expressed the view that recommendations for correction or prevention of problems should be made, in audit reports, wherever possible. He stated that the immense collective knowledge of the public sector, within the Audit Office, ensures that the Office is uniquely placed to make significant contributions to enhance the processes and controls across the public sector in Victoria.\(^{17}\)

Many observers believe that an effective performance audit requires not only the identification of problems but also recommendations aimed at solving those problems. Others hold the view that it is management's responsibility to develop solutions to address problems. Advocates of the latter view generally argue that managers are more appropriately placed to develop solutions to problems due to their knowledge of the operational aspects of the organisation. Solutions may be constrained by factors such as technology and the industrial relations environment and management will normally have a greater level of understanding of those areas. Further, the implementation of a project may be more successful, if the person responsible for implementation has also been responsible for the development of that project.

It is important that the Auditor-General maintains his independence and objectivity in reviewing and evaluating auditee systems. Statement of Auditing Practice AUP 33 - Performance Auditing, makes the following comments in relation to performance audits:

"Performance audits often include a great deal of discussion and consultation with management. Auditors should ensure that at all times their professional integrity, objectivity and independence, as well as that of all others involved in performing the audit, are maintained. Auditors will need to exercise particular care when making recommendations to address identified deficiencies. Auditors should consider the effect that offering such advice may have on audit objectivity in subsequent audits of the same entity. The auditors' recommendations may point to the direction in which positive changes can be made and to issues to be addressed in the process of"

\(^{17}\) Ryan, F., op. cit., page 45.
Review of a sample of the Auditor-General’s performance audit reports revealed
that audit recommendations are sometimes fairly broad and, on occasions, are
implied rather than expressly stated. The report on Visiting Medical Officer
Arrangements, for example, specified the need for improved VMO claim monitoring
and accountability processes. The reported failure of VMOs to notate patient
medical records infers a specific requirement that details of patient care, provided
by VMOs, should be recorded in the medical record. This recommendation,
however, was not explicitly stated within the report.

In response to a Committee request, the Auditor-General provided a document
which sets out the minimum processes identified by the Auditor-General’s staff to
ensure the adequacy of hospital controls over payments to VMOs (this document is
attached at appendix B). It is believed that a similar listing, within the special report
on Visiting Medical Officer Arrangements, might have provided considerable
assistance to hospital managers when attempting to address the issues raised in the
report.

While it is recognised that it is ultimately management’s responsibility to develop
detailed plans and to implement changes, it is also believed that the Auditor-
General could significantly assist management, in this respect, by providing, where
practicable and appropriate, specific and clearly articulated recommendations which
aim to address reported deficiencies. The Auditor-General’s officers will often be
well placed to recommend potential solutions due to their exposure to a broad range
of operational environments.

Finding 7.3

The Committee supports Mr Ryan’s view that performance audit reports should,
wherever possible, include recommendations for correction or prevention of
problems, and will monitor the progress made by the Audit Office, in this regard.

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18 Statement of Auditing Practice, AUP 33, Performance Auditing, issued by the Australian
Accounting Research Foundation on behalf of the Australian Society of Certified Practising
Accountants and the Institute of Chartered Accountants in Australia, para. 13.
CHAPTER EIGHT: AUDITOR-GENERAL’S RELATIONSHIPS WITH AUDITEES

8.1 OVERALL CONCLUSIONS

Mr Ryan noted that the Auditor-General handles his relationship with the Parliament effectively but that relationships with auditees could be improved. It was pointed out that since the Auditor-General has no mandate or responsibility to effect change, it is clearly essential to his effectiveness that he manages his relationships with those who can implement change.¹

It was found that the main issues giving rise to tension in relationships between the Auditor-General and his auditees are²:

- client service;
- fees; and
- timing of audit reports.

8.2 CLIENT SERVICE

Much of the auditee dissatisfaction dealt with issues that derive from an attitude to client service rather than with technical matters concerned with the execution of audits. It was therefore recommended that a client satisfaction cycle be incorporated into the audit plan.³

The Auditor-General, in response to a Committee questionnaire, has properly stated that he sees the Parliament as the client rather than the executive government or auditee management, and that he shares the view adopted by the Senate Standing Committee in its 1989 Report on Government Companies and their Reporting Requirements that the purpose of the public sector audit is to provide an independent report to Parliament on management, not a service to it.⁴ The Auditor-General further stated that:

² Ibid., page 5.
³ Ibid., page 48.
⁴ Auditor-General’s Response of 7 July 1993 to the Public Accounts and Estimates Committee Questionnaire, page 20.
"In the private sector, on which Fergus Ryan appears to be basing many of his remarks, external auditors are engaged by and therefore tend to see management as the 'client'.

As a result, a closer relationship is often built up with managers than might be considered desirable for objective, independent assessment of the operations of the organisation. The auditing profession has recently been warning auditors of the problems inherent in regarding managers, rather than company shareholders, as 'clients'. I believe that the different perspective taken by public and private sector auditors on who or what constitutes the 'client' underlies much of the tension that was apparently expressed to Fergus Ryan by some auditees."  

It was acknowledged by the Auditor-General that the "clear identification of both auditor and auditee expectations and roles can contribute to effective conduct of the public sector external audit and to the broader agenda of improvement of public resource management." The Auditor-General advised the Committee that, in this context, he and the Assistant Auditor-General have engaged in a series of meetings with each of the Ministers and with the Secretaries of the various departments to discuss expectations and the audit process generally.

In May of 1993, the Auditor-General tabled a special report - 'Information Technology in the Public Sector'. Six agencies were included in the Auditor-General's information technology performance audit review. The Committee, in seeking information which was relevant to its Inquiry into the Fergus Ryan report, invited those six agencies to submit their comments on the conduct of that audit or on any other aspects of the Auditor-General's audits which might be relevant to the Committee's Inquiry.

The Committee formally resolved, in accordance with sub-section 4J(3) of the Parliamentary Committees Act 1968, to accept the names of the six public sector agencies in private in order to maintain the confidentiality of the identity of those organisations. Under sub-section 4R(3) of the Act, the Committee is not permitted to disclose or publish any evidence it has accepted in private. For this reason, the names of the auditees have not been disclosed in this report.

Responses were received from all six of the agencies. Five of these agencies specifically commented on the conduct of the Auditor-General's performance audit.

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5 Ibid.
6 Ibid.
on information technology in the public sector, and all five expressed satisfaction with the way in which the audit was conducted. Specific comments included:

"..... found the Auditor-General’s approach to the review to be professional and valuable, in that it highlighted deficiencies that needed to be addressed."

"Overall, I have been satisfied with the financial audits and the recent Information Technology performance audit conducted by the Auditor-General."

"..... was fully satisfied with the performance audit, Information Technology in the Public Sector ..... The audit team from the Auditor-General’s Office was competent and efficient. There was a commendable level of consultation ..... prior to, during and in the follow up to the audit."

"The audit was carried out in an efficient and co-operative manner. Discussion regarding the nature of the audit, proposed methodology and the process for resolution of potentially costly issues were agreed prior to the commencement of the audit."

Specific concerns raised by auditees related primarily to the charging of performance audit fees and two of the respondents also expressed concerns about the cost of financial audits. Other issues raised by auditees related to the timing of financial audits and the need for more balanced audit reports. These issues had already been identified by Mr Fergus Ryan and are discussed at sections 6.2 and 7.6 of this report.

It is not proposed that the Auditor-General should develop a close relationship with auditee management as this could undermine the Auditor-General’s independence. It is also recognised that by its nature, the audit process will, at times, inevitably result in disagreements between the auditor and management and that this is sometimes caused by a lack of management understanding of the auditor’s role. Nonetheless, valid auditee concerns should be addressed. The way in which the Auditor-General identifies and resolves these concerns is a matter for him to decide.

The Auditor-General’s representations to the Committee, together with the results of the Committee’s more recent survey of auditees, leads the Committee to conclude that improvements have occurred in this area, and no specific action by the Committee is currently warranted. The Committee notes that the nature of this issue will require ongoing review and action by the Auditor-General.
8.3 FEES

8.3.1 Financial Audits

Mr Ryan stated that while most auditees accept the necessity for the charging of fees for financial audits, they are concerned as to whether they are receiving value for money. This concern derives primarily from their having no choice of an auditor. It was recommended that year to year fee charges and fee overruns should be negotiated so that auditees only bear the costs for which they are responsible.7

The Committee believes that for the most part, auditees should receive value for money from the Audit Office given that:

• Mr Ryan concluded that the Auditor-General is meeting his objectives effectively, economically and efficiently;

• the Audit Office is subject to triennial performance audit reviews (and accordingly will be subject to more rigorous scrutiny than will the majority of public sector entities);

• the Audit Office is not profit motivated but instead aims only to recover its costs; and

• the Audit Office sets its fees in accordance with guidelines issued by the Department of Treasury.

Any attempt to compare the Audit Office's fees with those of private sector entities is likely to be complex as it would necessitate an evaluation of the quality of the services provided as well as recognition of the practice adopted by some private sector accounting firms of minimising initial audit fees in order to obtain new clients. Such firms are able to recoup foregone profits at a later date when the auditor's knowledge of the entity enables a reduction in the amount of work undertaken in subsequent audits.

7 Ryan, F., op. cit., pages 49 and 50.
The proposition that auditees should be able to select their own auditors in order to ensure that they receive value for money needs to recognise that managers in the public sector owe a duty of accountability to the public (through the Parliament) and that the Auditor-General is an integral part of the accountability framework. Further, there are no guarantees that management will always seek to either maximise efficiency, or ensure an appropriate level of accountability, when appointing an auditor.

In order to negotiate yearly charges and fee overruns, an adjudication system would be required to resolve disputes between the Audit Office and the auditees. The Committee agrees with the view expressed by Mr Ryan, in his Report, that such a system would be "unattractively complicated and bureaucratic".\(^8\)

Given that the Audit Office complies with the Department of Treasury's guidelines when setting fees and charges, it is believed that reliance should be placed on the triennial performance audits of the Audit Office to ensure that the Office is operating at a level of efficiency which will ensure that fees reflect value for money.

Finding 8.1

The Committee believes that for the most part, financial audit fees, charged by the Audit Office, should reflect value for money given that:

- the Office sets its fees in accordance with Department of Treasury guidelines and aims only to recover its costs;

- Mr Fergus Ryan concluded that the Auditor-General is meeting his objectives effectively, economically and efficiently; and

- the Audit Office is subject to triennial performance audits.

\(^8\) Ibid., page 56.
8.3.2 Performance Audits

Mr Ryan reported that auditees are hostile to the concept of paying fees for performance audits and recommended that these should be funded by way of Parliamentary appropriation rather than by auditees.9

Evidence obtained by the Committee by way of submissions and public hearings indicated that the most common cause of auditee concern was in relation to performance audit fees. In particular, auditee concerns related to their inability to adequately plan and budget for performance audit fees. The Chief Executive Officer of the Zoo Board, at public hearing, stated:

"..... I don't have a problem with user pays as a principle at all, provided we can budget for it. The fact of not being able to budget is something that in Zoo Board terms is a lot of money. It throws our budget planning out, and its part of the generalised criticism in the Auditor-General’s report raised about the Zoo Board. To put it in context, $55,000 for a Zoo Board means we have to get an additional 10,000 people through the gate to pay for it, or we put off a medium sized exhibit, or we reduce by 2 or 3 staff members." 10

Given that the Parliament is the Auditor-General's client and that such audits represent an additional requirement which does not exist in the private sector, it is considered appropriate that Parliament funds performance audits. A discussion of the determination of performance audit fees, along with related recommendations, is contained in section 5.2 of this report. The Committee has been advised that proposed amendments to the Audit Act 1958 may include a provision that performance audits be funded by the Parliament. It is not known, at this stage, whether such an amendment will be passed by the Parliament.

**Recommendation 8.1**

Given that the Parliament is the Auditor-General's client, it is recommended that performance audits be funded by the Parliament rather than by auditees.

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9 Ibid., page 49.
8.4 TIMING OF REPORTS TO AUDITEES

Mr Ryan noted, in his Report, that there are unnecessary delays in formally advising auditees of the significant issues identified during financial audits.\textsuperscript{11} It was recommended that all issues should be communicated to the auditee, formally and in writing, as soon as practicable and at the latest within one month of completion of the audit. It was suggested that this would\textsuperscript{12}:

- result in earlier resolution of issues;
- ensure that auditees have sufficient time to clarify factual matters and formulate appropriate responses to matters raised in reports; and
- mean that the progress made to address issues could be noted in the Auditor-General's Report to the Parliament on Ministerial Portfolios and that this would encourage auditees to respond in a positive manner to audit findings and recommendations.

The Committee accepts the validity of the issues raised by Mr Ryan in relation to the timing of reports to auditees and encourages the Auditor-General to address this matter as promptly as possible.

Recommendation 8.2

The Committee concurs with Mr Ryan's finding that unnecessary delays in issuing audit reports is not conducive to the prompt resolution of problems identified by audit. Accordingly, it is recommended that the Auditor-General take action to rectify this matter.

\textsuperscript{11} Ryan, F., op. cit., pages 50 and 51.
\textsuperscript{12} Ibid., page 51.
9.1 DIVISIONAL STRUCTURE

Mr Ryan, in conducting his audit, noted that professional staff within the Audit Office are allocated to specific divisions and are only assigned to auditees within that division. There are approximately twelve staff (including the Director) in each field division.¹

Mr Ryan expressed the view that given the small size of divisions, the practice of assigning dedicated staff to each of these has negative consequences for the Office, its staff members and its auditees. These negative aspects include:²

- the frequency of changes of audit personnel is believed to be exacerbated by small divisional structures which necessitates the severing of relationships with existing auditees;

- the inability of the office to evaluate staff adequately as only one member of senior management gains any direct exposure to the performance of each subordinate; and

- the potential detriment to staff arising from the fact that staff are dependent upon the one member of senior management for the development of work style and for appraisal.

It was recommended that staff below Director level be pooled across the three divisions which report to a Chief Director of Audit.³

The Auditor-General has advised the Committee that the Office is undertaking an assessment of the advantages and disadvantages associated with the pooling of staff.⁴ A paper which sets out the features of the existing Office structure and those of two alternative models, as well as the matters to be considered in assessing each

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² Ibid.
³ Ibid.
⁴ Auditor-General's Response of 7 July 1993 to the Public Accounts and Estimates Committee Questionnaire, page 23.
of these arrangements, was provided to the Committee, by the Auditor-General, at public hearing on 1 September, 1993. No decision had, at that date, been made on the pooling of staff within the Audit Office.

The Committee believes that Mr Ryan has raised some valid concerns in relation to the existing divisional structure of the Office and that action should be taken, by senior management within the Office, to address these concerns as soon as possible.

Finding 9.1

The Committee concurs with Mr Ryan's finding that the pooling of staff, within the Audit Office, could provide benefits to auditees as well as to the Audit Office and its staff. The Committee will continue to monitor the status of this matter.

Recommendation 9.1

It is recommended that the Audit Office, in accordance with Mr Ryan's recommendation, pool all staff below Director of Audit level across the divisions reporting to a Chief Director of Audit.

9.2 POSSIBLE MOVE TO A STATUTORY AUTHORITY

Employees of the Audit Office are members of the Victorian Public Service. Mr Ryan stated that this arrangement places very significant constraints on the ability of the Auditor-General to make the decisions on matters of hiring, promotion and termination, which are necessary for the effective management of the Office.\(^5\)

It was suggested that consideration should be given to changing the status of the Audit Office to that of a separate statutory authority in order to enhance the Auditor-General’s ability to manage his business effectively.\(^6\)

There are many changes taking place in the public sector at the current time. Proposed legislative reforms to the Public Sector Management Act 1992 and the Audit Act 1958 as well as the proposed introduction of a Financial Management Act may impact upon the Auditor-General's ability to manage his Office in an effective manner.

\(^5\) Ryan, F., op. cit., page 53.
\(^6\) Ibid.
manner. In order to determine whether the Audit Office should become a statutory authority, the Committee will need to undertake a detailed assessment of the possible benefits and implications in light of recent and proposed legislative changes. Accordingly, the Committee will undertake a separate inquiry into this matter at a later date.

**Finding 9.2**

In view of pending legislative changes and the need for a full and detailed assessment of all possible implications, the Committee will undertake, at a later date, a separate inquiry into whether or not the Audit Office should become a statutory authority.
In performing an audit, the auditor documents, in the working papers, the various aspects of the auditee's operation which are relevant to the formation of an audit opinion. Documentation would include details of the auditee's activities and objectives, management structure, operational policies, planning and budgetary processes and management reporting and control systems. Audit plans and programs would also be developed and documented, and in the case of a performance audit, the auditor would also determine and document the criteria against which the auditee's operations, programs or activities are to be assessed. In conducting subsequent audits, the auditor would update documentation so that it reflects any changes which have occurred since the prior audit.

The working papers of an auditor are the property of that auditor and there is no obligation to make the working papers, or any information contained therein, available to another auditor.

Under the Audit Act 1958, a performance audit of the Auditor-General’s Office is to be undertaken at least once every three years. In order to ensure that the appointed auditor is not required to duplicate procedures which have been performed previously, it is believed that the appointed auditor should have access to the prior auditor's working papers and that provision for this to occur should be expressly included in the contractual arrangements.

Finding 10.1

The contractual terms and conditions relating to the appointment of an auditor to undertake the performance audit of the Audit Office, will in future, include an expressed requirement that the auditor's working papers are to be made available to the next auditor.

COMMITTEE ROOM

12 NOVEMBER, 1993
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BIBLIOGRAPHY


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LIST OF WITNESSES
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Australian Medical Association (Victorian Branch) - July 14, 1993
Dr E. Robyn Mason, Executive Director; Dr C. Scaife, Chairman, Branch Council; and Miss L. Moore, Assistant to Executive Director.

Australian Medical Association (Victorian Branch) - September 10, 1993
Dr E. Robyn Mason, Executive Director and Dr Clyde Scaife, Branch Council.

Department of Agriculture - May 19, 1993
The Honourable W. D. McGrath, Minister for Agriculture; Mr Terry Healy, General Manager, Rural Policy and Marketing; Dr Ras. Lawson, General Manager, Operations and Corporate Services; and Mr Ross Davies, Ministerial Advisor.

Department of Finance - April 14, 1993
The Honourable I. W. Smith, Minister for Finance; Mr D. Thomas, Secretary; Mr P. Kailis, Acting Comptroller-General (Policy); and Mr J. Norman, Acting Comptroller-General (Operations).

Department of Health and Community Services - August 18, 1993
The Honourable M. Tehan, Minister for Health and Dr J. Paterson, Secretary, Department of Health and Community Services.

Department of Treasury - September 17, 1993
The Honourable A. Stockdale, MLA, Treasurer of Victoria; Dr M. Vertigan, Secretary; Dr D. Sams, General Manager, Finance Group; Mr T. Martin, General Manager, Expenditure Management and Review Division; and Mr P. Coatman, Ministerial Advisor.

Mr C. C. Baird; Mr J. McAlister; Mr R. Andrews; and Mr M. Vanes. - September 22, 1993

Secretary to the Department of the Premier and Cabinet, Mr Ken Baxter - April 7, 1993
LIST OF WITNESSES

Victorian Audit Office - February 24, 1993

Mr C. Baragwanath, Auditor-General; Mr G. Hamilton, Assistant Auditor-General; Mr J. Manders, Chief Director of Audit; Mr J. Kehoe, Chief Director of Audit; Mr R. Walker, Chief Director of Audit; Mr T. Wood, Chief Director of Audit; and Ms J. Haskins, Executive Officer.

Victorian Audit Office - September 1, 1993

Mr C. Baragwanath, Auditor-General; Mr G. Hamilton, Assistant Auditor-General, Mr R. Walker, Chief Director of Audit; and Mr S. Naylor, Director of Audit.

Victorian Hospitals' Association - September 10, 1993

Mr A. Hughes, Executive Director; Mrs M. Smith, Director, Secretariat; Mr S. Capp, Chief Executive Officer of Mornington Peninsula Hospital and Honorary Member of the VHA; and Mr J. Smith, Chief Executive Officer, Nhill Hospital.

Zoological Board of Victoria - April 28, 1993

Mr Chris Larcombe, Chief Executive Officer.
LIST OF SUBMISSIONS
LIST OF ORGANISATIONS AND PERSONS PROVIDING WRITTEN AND ORAL SUBMISSIONS TO THE PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Auditees (6 organisations) included in the Auditor-General’s Performance Audit on Information Technology in the Public Sector.

Auditor-General, Australian National Audit Office, Mr John Taylor

Australian Medical Association (Victorian Branch)

Department of Agriculture

Department of Finance

Department of Health and Community Services

Department of Treasury

Mr C. C. Baird, Mr J. McAlister, Mr R. Andrews and Mr M. Vanes

Mr Fergus Ryan and Mr Stuart Gooley, Arthur Anderson

Premier of Victoria, The Honourable Jeff Kennett

Secretary to the Department of the Premier and Cabinet, Mr K. Baxter

The Treasurer of Victoria, The Honourable Alan Stockdale

Victorian Audit Office

Victorian Commission of Audit, Professor R. R. Officer (former Chairman) and Mr S. Eslake (former Executive Officer)

Victorian Hospitals’ Association

Zoological Board of Victoria
APPENDICES
APPENDIX A

SECTION 48B OF THE AUDIT ACT 1958
PERFORMANCE AUDIT OF THE AUDITOR-GENERAL

48B Performance audit of Auditor-General

(1) An audit shall be conducted under this section at least once every three years to determine whether the Auditor-General is achieving his or her objectives and doing so economically and efficiently and in compliance with this Act.

(2) An audit under this section shall be conducted by an auditor appointed by resolution of the Council and the Assembly, on the recommendation of the Economic and Budget Review Committee of the Parliament.

(3) An Auditor appointed under this section -

(a) shall be appointed on such terms and conditions and is entitled to such remuneration as are determined by the Economic and Budget Review Committee; and

(b) in conducting the audit, must comply with directions as to the audit given by that Committee.

(4) The remuneration payable to an Auditor appointed under this section shall be paid from the Consolidated Fund (which is hereby to the necessary extent appropriated accordingly).

(5) Subject to any directions given by the Economic and Budget Review Committee, sections 44, 44A, 44B and 45 apply in relation to an auditor appointed under this section as if references in those sections to the Auditor-General were references to the auditor appointed under this section.

(6) An Auditor appointed under this section must not make a report of an audit under this section unless, at least 28 days before making the report, the Auditor has given the Auditor-General a summary of findings and proposed recommendations in relation to the audit.

(7) The Auditor must include in the report of an audit under this section any submissions or comment made by the Auditor-General or a summary, in an agreed form, of any such submissions or comment.

(8) The Auditor, in a report of an audit under this section -

(a) may include such information as he or she thinks desirable in relation to matters that are the subject of the audit; and
APPENDIX A

(b) must set out the reasons for opinions expressed in the report; and

c) may include any recommendations arising out of the audit as he or she thinks fit to make.

(9) The Auditor must, within 7 sitting days after making the report, transmit the report to the Legislative Assembly.
APPENDIX B

DOCUMENT PREPARED BY THE AUDITOR-GENERAL'S OFFICE - HOSPITAL CONTROLS OVER THE REMUNERATION OF VMOs.

INTRODUCTION

The process that should be adopted by hospitals to substantiate the provision of services by Visiting Medical Officers (VMOs) is no more onerous, difficult or different from the practices adopted, or expected to be operating, in respect of the normal verification of expenditure associated with the purchase of any service.

The objectives associated with improving accountability are generally accepted. However, the debate is about the mechanisms which should be implemented by hospitals to improve the control over the acquisition of these services.

MINIMUM PROCESSES IDENTIFIED BY VICTORIAN AUDITOR-GENERAL'S OFFICE

The minimum processes should be:

Engagement (fee for service and sessional)

- VMO vacancies should be subject to open competition;
- appointments should be based on set criteria; and
- contracts should be entered into which include accountability requirements and private practice arrangements.

VMOs engaged on a fee for service basis

- All VMO services (date and time of service, details of service provided) should be recorded on the patient's medical record which enables accountability for service provision and standard of care;
- The invoice from the VMO should record date and time of attendance/service, description of service provided and the patient name;
- Invoice details should be checked against patients medical records to verify that the service has actually been provided, (and not paid for previously) and that the patient is not a private or compensable patient;
- The amount of individual claims should be checked against agreed contract schedule of rates;
Appendix B

- Directors of Medical Services should verify whether services were deemed to be necessary and appropriate to the condition of the patient; and

- A framework for peer review and quality assurance should be established by hospitals to review the methods of service provision and the quality of services.

VMOs engaged on sessional basis

Sessional VMO rosters should be maintained for both in-hours and out-of-hours work by the Director of Medical Services which clearly detail the agreed work allocation for each VMO and include:

- number of sessions to be worked;
- classification of session, (i.e. theatre/ward/outpatients/administrative);
- type of session, (i.e. standard, composite or abbreviated); and
- an indication of whether the VMO is on exclusive or consultative recall.

In respect of each pay period, a sessional VMO should submit a record of attendances (dates and times) including details of any out-of-hours work and leave taken.

All services involving direct patient care should be recorded by the VMO on the patient's medical record.

The Director of Medical Services should verify whether:

- all sessions were in fact worked and correspond to the rostered sessions;
- any leave taken had been authorised; and
- out-of-hours work (exclusive or consultative recall) was in fact undertaken.

The Director of Medical Services should ensure that the number of private patients treated by each sessional VMO during publicly paid sessions is in accordance with the VMO's contract of engagement and hospital policy.

Rates and allowances to be paid to VMO's should be in accordance with the contract entered into.
APPENDIX B

INSTRUCTIONS ISSUED BY THE DEPARTMENT

The Department of Health and Community Services recently released (July 1993) an updated Finance and Accounting Manual for Public Hospitals which include instructions on Payments to Visiting Medical Practitioners. These instructions, which are listed below, are consistent with the recommendations of the Auditor-General.

"These payments and the documentation supporting them must be subject to controls which are similar to those applying to payments to other suppliers, that is:

- checking of invoices against patient records to ensure that the service has been rendered;
- checking to ensure that the service is closely related to the patients' needs;
- checking for appropriate pricing with respect to Commonwealth Medical Benefits Schedules;
- checking that the charge does not duplicate another attendance;
- checking that oncall and recall charges are appropriate; and
- checking that the invoice has been received by the hospital in accordance with its usual procurement and payment terms.

A number of the above checks require access to patient records and should be performed by a medical records officer prior to signed approval of the invoice by the Director of Medical Services or his/her deputy."

The internal controls are to be supplemented by a delegated Finance Department officer checking the invoice and initialling it prior to payment. The invoices must accompany the cheques when presented to the cheque signatories who should evidence their approval on the invoices or batch summary sheet."
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