



PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

FORTY-EIGHTH REPORT TO PARLIAMENT

REVIEW OF THE REPORT ON THE 2001 PERFORMANCE AUDIT OF THE VICTORIAN AUDITOR-GENERAL'S OFFICE

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Public Accounts and Estimates Committee

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE MEMBERSHIP - 54TH PARLIAMENT

Mr P Loney, MP (Chairman)

Ms A Barker, MP

Mr R Clark, MP

Ms S Davies, MP

Hon. D Davis, MLC

Hon. R Hallam, MLC (Deputy Chairman)

Mr T Holding, MP

Mrs J Maddigan, MP

Hon. G Rich-Phillips, MLC

Hon. T Theophanous, MLC

This Inquiry was undertaken by a Sub-Committee comprising the following Members:

Mr P Loney, MP (Chairman)

Mr R Clark, MP

Hon. R Hallam, MLC

Mr T Holding, MP

Public Accounts and Estimates Committee

Staff:

Executive Officer: Ms Michele Cornwell

Assistant Executive Officer: Ms Frances Essaber

Office Manager: Mrs Christine Walker

Specialist Adviser: Mr Trevor Wood

Committee's contact details:

Address: Level 8, 35 Spring Street
Melbourne Victoria 3000

Telephone: (03) 9651 3556

Facsimile: (03) 9651 3552

Email: paec@parliament.vic.gov.au

Internet: <http://www.parliament.vic.gov.au/paec>

DUTIES OF THE COMMITTEE

The Public Accounts and Estimates Committee is a joint parliamentary committee constituted under the *Parliamentary Committees Act 1968*, as amended.

The Committee comprises ten Members of Parliament drawn from both Houses of Parliament and all political parties and includes an Independent Member.

The Committee carries out investigations and reports to Parliament on matters associated with State financial management. Its functions under the Act are to inquire into, consider and report to the Parliament on:

- (a) any proposal, matter or thing connected with public administration or public sector finances;
- (b) the annual estimates or receipts and payments and other budget papers and supplementary estimates of receipts and payments presented to the Assembly and the Council.

In consultation with the Auditor-General, the Committee determines the objectives of performance audits and identifies any particular issues that need to be addressed during these audits.

CHAIRMAN'S INTRODUCTION

It is a statutory requirement that the review of the Victorian Auditor-General's Office (VAGO) be undertaken every three years by an independent auditor appointed by the Public Accounts and Estimates Committee. The performance audit serves to ensure that the work of the Auditor-General remains accountable and of the highest standard.

This report examines and comments on the findings and recommendations contained in the report on the independent performance audit (the Alford Report) of the Victorian Auditor-General's Office. The Alford Report identified that the past three years have been a period of challenge and accomplishment for the Office.

The overall findings of the performance audit are favourable and indicate that the Auditor-General is meeting his objectives effectively, economically and efficiently and in compliance with the Audit Act. The report also indicates that the management and operational changes implemented over the past three years resulted in improvements at the Auditor-General's Office. The Committee commends the former Auditor-General, Mr Ches Baragwanth, and the present Auditor-General, Mr Wayne Cameron, and the staff of the VAGO for these improvements and continuing positive initiatives.

The independent auditor's report also identifies and targets areas for improvement and constructively prescribes ways in which the operations of the Office may be made more efficient and effective to ensure that the Victorian Auditor-General's Office continues to be a world leader in public sector auditing.

The Committee wishes to thank the performance auditor, Mr Stuart Alford, for undertaking the audit, and the Secretary of the Department of Treasury and Finance, Mr Ian Little, and the Auditor-General, Mr Wayne Cameron, for their advice on issues raised in the report of the performance auditor.

I also wish to record my appreciation to Members of the Sub-Committee that undertook this review and particularly the Deputy Chairman, Hon. Roger Hallam, MLC, and to Mr Trevor Wood of the PAEC secretariat who provided research assistance to the Sub-Committee.

As a result of the Committee's expanded role in relation to the Auditor-General's Office, an opportunity exists for a strengthened, mutually productive relationship to develop between the Committee and the Auditor-General in the coming years, which will serve to enhance the Parliament's independent scrutiny of the Government.

I believe that the Victorian Auditor-General's Office is well placed to meet the challenges ahead.

A handwritten signature in black ink, appearing to read 'Peter Loney', with a large, stylized flourish at the end.

Peter Loney, MP
Chairman

RECOMMENDATION

Recommendation 4.1:

The Audit Act be amended to provide that the performance audit of the Victorian Auditor-General's Office be undertaken by a suitably qualified person, recommended by the Public Accounts and Estimates Committee and appointed by resolution of the Legislative Council and the Legislative Assembly.

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CHAPTER 1: BACKGROUND TO THE INQUIRY

1.1 Legislative requirements

The *Audit Act* 1994, as amended, provides for an independent performance audit of the Victorian Auditor-General's Office to be conducted at least once every three years by an auditor appointed by Parliament. The Public Accounts and Estimates Committee is responsible for recommending the appointment of an auditor.

Section 19 of the Audit Act, as amended, 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 effectively 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 Legislative Council and the Legislative Assembly, on the recommendation of the Public Accounts and Estimates Committee.

1.2 Background

Previous performance audits conducted in 1992 and 1995 were wide-ranging and retrospectively reviewed all aspects of the operations of the Victorian Auditor-General's Office over a three year period.

In December 1997, major amendments to the audit legislation involved significant changes to the role and responsibilities of the Auditor-General and the Victorian Auditor-General's Office (VAGO). The key features of the amendments were:

- designation of the Auditor-General as an independent Officer of the Parliament;

- introduction of a requirement for the Auditor-General to appoint external contractors, following a process of contestability, to undertake or conduct financial and performance audits;
- establishment of a new statutory body, Audit Victoria, to operate under a Board of Directors appointed by the Government. After initial staffing by personnel transferred from the Auditor-General's Office, to participate in the audit contestability process along with private sector service providers; and
- progressive implementation of the contestability regime from 1 July 1998.

As a result of these significant changes, the Committee considered that a full retrospective review of the Office's operations since the previous performance audit in 1995 was inappropriate given the changes that were occurring. Consequently, the focus of the 1998 performance audit was on the activities of the Auditor-General's Office as it made the transition to a contestable audit services regime.

Since the 1998 performance audit, significant amendments were made to the Constitution Act and the Audit Act which resulted in:

- enshrining within the Constitution Act provisions relating to the appointment, independence and tenure of the Auditor-General as an independent Officer of Parliament;
- re-integration of Audit Victoria back into the Victorian Auditor-General's Office from 1 January 2000;
- strengthening the relationship of the Auditor-General with Parliament and the accountability of the Auditor-General to Parliament; and
- removal of the legislative requirement for the Auditor-General to contract out audits.

In addition, Mr Ches Baragwanath retired as Auditor-General in 1999 and Mr Wayne Cameron was appointed as his successor.

These changes have resulted in a major restructure of the Office and the adoption of a new approach.

In view of these significant changes within the Office, the emphasis during this performance audit was on assessing the ongoing effectiveness of the processes developed by the Auditor-General's Office in response to the changes in the role of the Office.

1.3 Appointment of a Performance Auditor

The Committee recommended to the Parliament that Mr Stuart Alford, a Senior Partner from Ernst & Young, and Chairman of the Auditing and Assurance Standards Board and the Australian accounting profession's representative on the Committee of the International Federation of Accountants, be appointed as the auditor to conduct the 2001 performance audit of the Auditor-General's Office. The appointment was endorsed by the Parliament in May 2001.

1.4 Committee's directions to the Performance Auditor

The overall objective of the performance audit was to determine whether the Victorian Auditor-General's Office is achieving its objectives effectively, economically and efficiently and in compliance with the Audit Act. In this context and without limiting the scope of the audit, the Committee directed the auditor to address the following specific matters:

- (1) Assess the appropriateness of the outcomes, objectives, action strategies and performance measures and outcome targets set by the Auditor-General in his Annual Plan and determine the extent to which they are being achieved.
- (2) Review key management issues, including:
 - (a) the adequacy and effectiveness of the annual planning process;
 - (b) the adequacy and effectiveness of systems to measure and improve productivity;

- (c) the adequacy of the existing costing system to ensure all recoverable costs are collected for Government and that there is no cross-subsidisation between chargeable and non-chargeable functions of the Office;
 - (d) the culture of management and its effect on performance;
 - (e) the effectiveness of the relationship between the Office and its clients (particularly the Public Accounts and Estimates Committee and the Parliament) and any factors influencing those relationships;
 - (f) the extent to which best practice in public sector management has been adopted in the Office, and
 - (g) whether the Office complies with Australian auditing standards.
- (3) Review the efficiency and effectiveness of the management and conduct of performance audits undertaken by the Office, with particular attention to:
- (a) the extent to which the criteria for selecting performance audits address the public interest and high risk areas of Government;
 - (b) the extent to which selection criteria for performance audits ensure key programs in areas of Government receive adequate coverage;
 - (c) the effectiveness of the planning and management of performance audits;
 - (d) compliance with statutory requirements for the conduct and reporting of performance audits;
 - (e) whether the methodologies and practices used by the Office for the conduct of performance audits, including the engagement of contractors on behalf of the Auditor-General to assist in and/or undertake particular audits, are appropriate and well managed;

- (f) the adequacy of the investigative process and the evidential material to support conclusions arising from the reports of the performance audits;
 - (g) the appropriateness of quality control procedures including the communication of findings to all audited agencies with an interest in such findings;
 - (h) the appropriateness of the mix between specialist expertise, contractors and in-house staff in undertaking particular performance audits;
 - (i) the appropriateness of criteria against which the efficiency and effectiveness of performance audits conducted by the Office are measured; and
 - (j) whether the performance audit program and reports are meeting the information requirements of the Public Accounts and Estimates Committee, the Parliament and the community.
- (4) Determine whether the methodologies and practices used by the Auditor-General for the conduct of financial statement audits and other audits, including the engagement of contractors on his behalf to assist in and/or undertake these audits, are appropriate and well managed.
- (5) Survey a representative sample of users of the Auditor-General's reports to the Parliament (Members of Parliament, Public Accounts and Estimates Committee, representatives of Executive Government and the community including key interest groups), to determine whether the Auditor-General is meeting his objectives, particularly in delivering value-adding reports to agencies and Parliament and providing value for money to the Parliament and the Victorian community.
- (6) Identify clear recommendations capable of implementation to effect improvement where deemed possible/desirable.

The Committee further directed the auditor to:

- (a) conduct the audit in compliance with the *Audit Act 1994*, as amended; and
- (b) conduct the audit in compliance with Statement of Auditing Practice AUP33 'Performance Auditing' and other relevant Auditing Standards and Statements.

The report of the performance audit was required to:

- specify the performance measurers and benchmarks (both qualitative and quantitative) against which the Victorian Auditor-General's Office was measured and assessed;
- provide an opinion on the Victorian Auditor-General's Office's compliance with Australian auditing and accounting standards; and
- provide an overall opinion as to whether the Victorian Auditor-General's Office is achieving its objectives effectively, economically and efficiently and in compliance with the *Audit Act 1994*, as amended.

1.5 Timing of the report

Mr Alford's report on the 2001 performance audit of the Victorian Auditor-General's Office was forwarded to the Presiding Officers of the Parliament on 18 October 2001 and tabled in the Legislative Council and the Legislative Assembly on 30 October 2001.

CHAPTER 2: REVIEW OF THE PERFORMANCE AUDIT REPORT

2.1 Process followed by the Committee

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

- seeking written submissions on the findings and recommendations contained in the report from the Secretary of the Department of Treasury and Finance and the Auditor-General; and
- holding private hearings with the Auditor-General and officers of the Victorian Auditor-General's Office, and the Deputy Secretary and the Director, Financial Policy and Compliance, Department of Treasury and Finance.

2.2 Key findings and recommendations

In forwarding his report to the Presiding Officers of the Parliament, Mr Alford advised that he appreciated the co-operation and assistance received from the Auditor-General and his staff throughout the conduct of the performance audit.

Mr Alford concluded that, in his opinion, the Victorian Auditor-General's Office is:

- complying with Australian auditing and accounting standards; and
- achieving its objectives effectively, economically and efficiently and in compliance with the Audit Act.

Mr Alford made a number of recommendations and suggestions to further improve the efficiency and effectiveness of the operations of the Victorian Auditor-General's Office. In making the recommendations, Mr Alford acknowledged that since the last performance audit in 1998, the Victorian Auditor-General's Office has experienced significant changes to its auditing and reporting

responsibilities. These changes, including the re-merging of the facilities and staff of Audit Victoria back into the Office, have had a significant impact on the organisation of the Victorian Auditor-General's Office, resulting in a restructure of the Office and a reshaping of its directions. These events influenced the approach and focus of the audit examination undertaken by Mr Alford.

Findings and recommendations contained in the report of the Performance Audit of the Victorian Auditor-General's Office along with responses from the Auditor-General and the Secretary of the Department of Treasury and Finance, and the Committee's comments, follow.

2.3 Structure and management of the Victorian Auditor-General's Office

2.3.1 *Audit Committee*

Performance Auditor's Findings

The governance arrangements, including the manner in which the Board of Management, Audit Committee and the internal auditor are involved, are appropriate for directing and monitoring the activities of the Office. The Audit Committee has discussed the addition of a further independent member with current commercial experience relevant to the Office.

(Reference within the report on pages 2, 17 and 18)

Performance Auditor's Recommendations

That such an appointment be pursued, as it would provide a further and fresh external perspective to the Auditor-General to assist him in the discharge of his responsibilities.

Auditor-General's Comments

Agree - the Office is seeking a suitable person.

Committee's Comments

The Committee supports the auditor's recommendation.

2.3.2 *Role of internal auditor*

Performance Auditor's Findings

The topics included in the internal audit program have been based on good practice and historical experience rather than being developed from an overall assessment of areas of risk within the Victorian Auditor-General's Office. *(Reference within the report on pages 3 and 18)*

Performance Auditor's Recommendation

The conduct of a risk assessment as part of the planning activities of the Office would be informative to the Audit Committee and would assist them in directing and focussing the available internal audit resources.

Auditor-General's Comments

Agree – some steps were taken in that direction during the last internal audit, but further consideration will be given to a business-wide assessment.

Committee's Comments

An internal audit function would normally involve undertaking a risk assessment within an organisation and designing an internal audit program to address key areas of risk to an organisation's activities. The Committee believes that the role of the Audit Committee should include:

- ensuring that the internal audit function is effective, not only in respect of its charter, but also in respect of the adequacy of the internal audit program in identifying risks; and

- assessing the effectiveness of internal controls in place to address such risks.

Consideration could be given to the Audit Committee benchmarking the Office's internal audit function against other Audit Offices in Australia.

2.3.3 Conflicts of interest

Performance Auditor's Findings

Declarations regarding Independence and Conflicts of Interest are obtained on an annual basis from all executives.
(Reference within the report on page 22)

Performance Auditor's Recommendation

Declarations should be obtained at the point of employment and kept up-to-date for all employees of the Office.

Auditor-General's Comments

The current approach will continue for all executive staff. However, the Office will ensure that for other staff, policies will require staff to advise of any potential conflicts at the time audit or other activities are undertaken.

Committee's Comments

The Committee acknowledges the action taken by the Auditor-General to ensure that the independence and objectivity of the staff is not compromised.

2.3.4 *Recruitment of staff*

Performance Auditor's Findings

The graduate recruiting and retention practices followed by the Office are constrained by its ability to compete with the large accounting firms for new staff, and the rigidity of public service award structures and promotion policies. This is impacting on the ability to attract new staff to the financial audit area as well as the ability to retain graduates with three to four year's experience.
(Reference within the report on page 22)

Performance Auditor's Recommendation

To achieve its objective to be identified as a preferred employer, the Victorian Auditor-General's Office must develop innovative new recruitment and retention strategies that differentiate it from other employers and demonstrate attractive career progression.

Auditor-General's Comments

A number of initiatives have or will be implemented over the course of the year, including

- a new interactive web-based recruitment opportunities link on the Office's home page. This facility will provide information on positions available within the Office as well as an indication of vacant positions. It is expected that this will be implemented by June 2002;
- linking of the Office's Web Page (Recruitment Opportunities) to the Graduate Council of Australia web page which informs university students of recruitment opportunities as they arise. This facility will be implemented by June 2002;
- development of a new Graduate package that emphasises the personal and professional developmental opportunities available in the Office; and

- reviewing existing recruitment practice.

Committee's Comments

The Committee accepts that the Auditor-General is taking appropriate steps to recruit staff to the Victorian Auditor-General's Office. The Committee notes that the Auditor-General's response does not outline the specific measures taken by the Office to actively promote professional development activities. Ideally, professional development for all staff should be directly linked to staff assessments as well as emerging developments in financial statement auditing and performance auditing, both in Australia and overseas. Attention to this aspect will be an important factor, not only in encouraging retention of skilled staff, but in further improving the quality of the services provided by the Office.

2.4 Information Technology

2.4.1 *Future strategies for Information Technology*

Performance Auditor's Findings

Although the Information Technology appeared appropriate and adequate to support the requirements of the Victorian Auditor-General's Office, the Office was considering whether the current applications will continue to be appropriate to support its long-term strategies.
(Reference within the report on pages 3 and 22)

Performance Auditor's Recommendation

The Office must give consideration to the nature of applications needed in the future to support its administrative systems as well as its audit practice.

Auditor-General's Comments

An Information Technology strategic plan that is derived from the corporate plan and directly supports the business objectives of the Office will be developed in conjunction with addressing immediate priority areas.

Committee's Comments

The Committee agrees with the recommendation of the Performance Auditor. The Office needs to ensure that maximum benefit is being obtained from available Information Technology systems to support its audit practice including use of the Internet, where appropriate, modern business systems and the capture of management information essential to realise corporate objectives.

2.4.2 *Leasing option for Information Technology*

Performance Auditor's Findings

No detailed Information Technology capital expenditure budget has been prepared pending the outcome of the Office's review of its Information Technology strategy.
(Reference within the report on page 22)

Performance Auditor's Recommendations

The current practice of purchasing hardware outright should be reviewed to determine whether the more common practice of leasing assets might provide a more cost effective solution to maintaining a current information technology environment.

Auditor-General's Comments

The major part of funding for information technology has been approved by Treasury as capital funds rather than lease funds. The use of capital funding was suggested by Treasury.

Committee's Comments

Although the auditor's recommendation to lease information technology assets has merit, it would appear from the Auditor-General's response that the Department of Treasury and Finance preferred to provide capital funds rather than enter into leasing arrangements. The Auditor-General's Annual Report for 2000-2001 drew attention to the need to upgrade the information technology infrastructure to replace obsolete hardware and software, improve response times, improve reliability and reduce maintenance and running costs.

The Committee acknowledges that these matters, in conjunction with a range of other information technology-related issues, are currently under review within the Office. However, the Committee supports the concept of leasing suitable hardware if it can be proven to be cost effective and efficient in maintaining an up-to-date information technology environment that meets the immediate and future needs of the Auditor-General's Office.

2.4.3 *Information Technology back-up*

Performance Auditor's Findings

While onsite and offsite back-up tapes are cycled on a weekly basis, there is currently no designated backup facility available in the event of a disaster at the William Street site.

(Reference within the report on page 23)

Performance Auditor's Recommendation

An appropriate back-up facility should be identified.

Auditor-General's Comments

A disaster recovery site facility is included in the specification for the information technology infrastructure upgrade.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation, particularly given the huge volume of information, sometimes sensitive, held for planning purposes which would be very difficult to replicate.

2.4.4 Access controls

Performance Auditor's Findings

The Office maintains effectively documented IT resource guides which dictate good password practices and address the major issues associated with maintaining the integrity and confidentiality of the Office's systems and data. In addition, the firewall and networking security features of the IT system have proved successful in repelling unauthorised attempts to access the Office's databases.
(Reference within the report on page 23)

Performance Auditor's Recommendation

A formal security review of access controls (including some form of attack and protection exercise with respect to remote access controls) should be considered to ensure that the documented controls are comprehensive and that security policies are being kept up-to-date with best practice.

Auditor-General's Comments

Information technology security requirements were reviewed and considered as part of the development of the information technology infrastructure upgrade. The upgrade will include updated documentation of the revised arrangements.

Committee's Comments

The Committee acknowledges the actions being taken by the Auditor-General to upgrade security arrangements for access to

the Office's information technology environment. These arrangements should be reviewed as part of future performance audits of the Auditor-General's Office.

2.4.5 Internet policies

Performance Auditor's Findings

Policies and procedures regarding use of the Internet are documented and the Office is preparing to implement the requirement to have employees sign acceptance of these policies.

(Reference within the report on page 23)

Performance Auditor's Recommendation

A compliance statement acknowledging acceptance of all information technology policies and procedures in relation to Internet use should be completed by employees on an annual basis.

Auditor-General's Comments

A compliance statement acknowledging acceptance of information technology policies is near finalisation. On acceptance by the Board of Management, all staff will be required to sign this statement on an annual basis.

Committee's Comments

The Committee supports the action proposed by the Auditor-General.

2.5 Finance and administration

2.5.1 *Major variances in operating statements*

Performance Auditor's Findings

Operating statements for the Office are prepared and regularly submitted to Board of Management meetings. These operating statements contain a comparison of budgeted and actual activity and present the resulting variances without an accompanying explanation for major variances.

(Reference within the report on page 23)

Performance Auditor's Recommendation

The usefulness of the financial information could be enhanced by the inclusion of commentary to also explain the reasons for major variances arising.

Auditor-General's Comments

An overall narrative is provided on the financial statements. Narrations will be provided at the cost centre level.

Committee's Comments

The Committee notes the Auditor-General's comments.

2.5.2 *Billing of audit fees*

Performance Auditor's Findings

Billings for audit fees charged to clients are closely monitored and outstanding receivables are highlighted for directors to follow up with the agency concerned. The Office has proposed introducing a system of billing dates and responsibilities within each month to reduce the administrative pressures at month end.

(Reference within the report on page 24)

Performance Auditor's Recommendation

An alternative to the introduction of a system of billing dates and responsibilities within each month would be to schedule billing dates as part of the audit engagement planning process. This would facilitate administrative assistants raising billings at pre-arranged dates and remove some of the administrative burden from the audit directors.

Auditor-General's Comments

Billing processes are to be reconsidered as part of the introduction of a new practice management system in 2002. Progressive billing will be part of that reconsideration.

Committee's Comments

It is important that all government revenue is brought to account as soon as possible. In this regard, the Committee is pleased that the Auditor-General is examining billing practices with a view to initiating improvements.

2.5.3 *Audit Management Information System*

Performance Auditor's Finding

The application currently used for the recording of time and cost within the Office known as AMIS (Audit Management Information System) was purpose built for the Victorian Auditor-General's Office. The Office has struggled to extract relevant information from a system which is neither user friendly nor adequately supported. *(Reference within the report on pages 3 and 24)*

Performance Auditor's Recommendation

Serious consideration is being given by the Office to replacing the AMIS application. This initiative is strongly supported and in doing so, consideration could also be given to:

- reporting actual time spent by all staff groups on a consistent basis against the resource plan;
- enhancing productivity management by developing productivity and variance management goals as output performance indicators for all staff; and
- requiring groups such as Accounting and Auditing Policy and Sector Liaison to charge their time directly to specific audit engagements instead of treating their time as an overhead recovery charge to clients.

Auditor-General's Comments

Specifications for the replacement of AMIS are currently being developed and these matters will be considered as part of that process.

Committee's Comments

The Committee supports the recommendation of the Performance Auditor, given the limitations of the existing management

information system within the Auditor-General's Office. The Committee believes it is important that the costing system provides for all recoverable costs allocated to audits to be appropriately charged and collected and that there is no cross-subscription between clients or between the chargeable and non-chargeable functions of the Office.

2.5.4 Review of arrangements relating to time and cost management

Performance Auditor's Findings

In line with the recommendation that time consumed by certain support groups within the Auditor-General's Office should be charged directly to the audit functions to which they relate, it was also observed by the Performance Auditor that in the absence of the above function occurring, the Office is not in a position to determine the percentage of time expended by these support groups on specific audit engagements, research activities and other activities such as quality control.

(Reference within the report on pages 3 and 24)

Performance Auditor's Recommendation

More attention should be given to the establishment and use of utilisation percentages as performance indicators in order that the Office can enhance its ability to understand how time is being used in supporting client-related activities.

Auditor-General's Comments

Productivity reports are now produced and tabled monthly at the Board of Management meetings.

Committee's Comments

In terms of maximising productivity and adding value to the audit process, the Committee agrees with the Performance Auditor's

recommendation that the time and cost of support functions should be capable of identification and measurement across relevant audit activities. Certain of these support functions, such as sector liaison came about as a result of the re-structure of the Office and to some extent the tasks undertaken within these groups were previously undertaken by Directors. Through effective time measurement and appropriate performance indicators, the contribution to corporate objectives these groups make should be capable of identification.

2.5.5 Audit costs

Performance Auditor's Findings

An amendment to the Audit Act in 2000 placed an obligation on the Auditor-General to review and report to Parliament on the Estimated Financial Statements prepared by the Department of Treasury and Finance as part of the annual budget reporting process. However, the costs incurred by the Office in undertaking this function are not recouped from the Department.

(Reference within the report on pages 3, 24 and 41)

Performance Auditor's Recommendation

The cost of activities relating to the review of the Estimated Financial Statements is not re-charged by the Office. Consideration should be given (through legislative change) to arranging for these costs to be met by the Department of Treasury and Finance.

Auditor-General's Comments

Agreed – it is anticipated that the annual review of the Estimated Financial Statements will become a chargeable activity under the Audit (Further Amendment) Bill currently before the Parliament.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation that the ability to recoup the costs imposes a discipline upon the Auditor-General's Office to plan and accurately project the cost of the audit and to undertake it within the financial budget set.

2.6 Corporate and annual planning processes

2.6.1 *Planning information*

Performance Auditor's Findings

As a result of the restructure of the Office in conjunction with the recruitment of executives into Strategic Planning and Sector Liaison, Accounting and Auditing Policy, a very significant information and knowledge database has been developed for each public sector portfolio in which the Auditor-General is involved. The database is subsequently utilised for the planning of performance and financial statement audit activities as well as providing a basis for informed liaison with stakeholders.

(Reference within the report on pages 4 and 24)

Performance Auditor's Recommendation

The sector knowledge now being captured and managed through planning and liaison activities provides a competitive advantage that should be pro-actively leveraged for the benefit of the Victorian Auditor-General's Office and its stakeholders.

Auditor-General's Comments

This information is currently available for use within the Office and methods to enhance its dissemination are being pursued. The information included in the plans can be used to facilitate discussions with stakeholders, including service providers.

Committee's Comments

The Committee recognises the substantial benefits occurring from the database maintained by the Auditor-General's Office. Information derived from the database should also contribute to the quality of performance audit specifications reviewed by the Committee.

2.6.2 Risk assessment of Office

Performance Auditor's Findings

The Strategic Planning and Sector Leadership group within the Auditor-General's Office conducts a detailed "environmental scan" aimed at identifying emerging public sector developments and any consequential accountability implications that may impact upon the activities of the Office. The knowledge captured through this process is mainly used for strategic planning purposes. *(Reference within the report on pages 4, 26 and 27)*

Performance Auditor's Recommendation

In conducting the environmental scan, consideration should also be given to the internal environment of the Office by including a formal step in the planning process to undertake a risk assessment at both corporate and business unit levels.

Auditor-General's Comments

Agree – consideration will be given to a business wide assessment.

Committee's Comments

The Performance Auditor's recommendation is supported. A risk assessment within the Office would be useful for internal audit purposes and may also further assist the Office in meeting its corporate objectives.

2.6.3 *Office objectives*

Performance Auditor's Findings

The Performance Auditor indicated that the performance measures and output targets utilised by the Office to determine whether Office objectives were met, did not adequately relate to the objectives set. In effect, stakeholders in the Office should be able to readily determine from the outputs and performance measures used whether objectives were achieved.
(Reference within the report on page 27)

Performance Auditor's Recommendation

Analysis of the output targets and performance measures published in the Office's Annual Plans suggest that they could be made more effective by further analysis of the objectives to which they relate.

Auditor-General's Comments

Agreed – such analysis is planned, as more specific user information is progressively obtained from stakeholders through focus group meetings with selected parties and face to face discussions with Members of Parliament and public sector agencies.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation that output targets and performance measures should provide a meaningful indication, from an external viewpoint, as to whether corporate objectives are actually being met.

2.6.4 *Enhancement of performance indicators for executives and managers*

Performance Auditor's Findings

The Performance Auditor observed that the Corporate Plan devolves into the separate planning activities of each business, operating and service group within the Office. In turn, this framework results in separate business plans being developed for each group in a manner that aligns the objectives, strategies, performance measures and key targets of each group, with the Annual Plan for the Office. Closely aligned to this process is a Performance Management System, which is meant to align individual duties and goals for staff with the respective business plan. However, scope for improvement was warranted as part of this alignment.

(Reference within the report on pages 4, 26 and 27)

Performance Auditor's Recommendation

Further alignment and integration of the planning strategies into the management practices of the Office was required. This could be achieved through the enhancement of existing key performance indicators for all executives and managers within the Office as part of the performance appraisal system.

Auditor-General's Comments

The existing Performance Management System provides for the alignment of planning strategies. Additional training was provided to all staff in July 2001 to assist them with the identification of relevant and measurable key performance indicators that are aligned with the Office's Annual Business Plans. Further modifications to the existing Performance Management System have taken place to include post audit/major project work reviews. This has been incorporated to further improve the appraisal elements of the existing performance management program.

Committee's Comments

It is important that stakeholders, including the Committee, should be able to determine from the Office's Annual Report whether Corporate Objectives of the Auditor-General's Office are being achieved through the use of key performance measures that are relevant to the objectives stated. Key performance indicators set for executives and managers within the Office need to be closely aligned to the measures outlined in the Annual Report for the achievement of corporate objectives.

2.7 Performance auditing

2.7.1 *Selection of performance audit topics*

Performance Auditor's Findings

The implementation of the Office's new strategic audit planning has resulted in the development of individual strategic Audit Plans for each of the major portfolio sectors in the Victorian public sector environment. The Office's Annual Plan in turn includes potential performance audits identified as part of the strategic planning process. Nevertheless, detail is not provided as to specifically why the potential performance audits were selected and prioritised in terms of factors such as public interest, materiality, risk or potential for enhanced accountability. *(Reference within the report on pages 4, 29 and 30)*

Performance Auditor's Recommendation

The usefulness of information published about the Office's planning process, including that provided to the Public Accounts and Estimates Committee, would be significantly enhanced if more transparency and explanation was provided about how and why particular criteria were applied in the identification of topics and how particular topics came to be prioritised.

Auditor-General's Comments

The Office will look to enhance the information provided in relation to the selection of projects.

Department of Treasury and Finance Comments

The Department of Treasury and Finance strongly supports the recommendation for the Office to explain how and why particular criteria were applied in the identification of audit topics. This would enable agencies to better understand the audit process and ultimately to better utilise the outcomes of the Office's reviews.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation that there needs to be greater transparency in the selection of performance audit topics. The Committee is keen for the resources applied to performance auditing by the Auditor-General to focus on areas within government which relate to high risk and materiality issues and have a high public interest component.

2.7.2 *Excessive documentation*

Performance Auditor's Findings

The extent of documentation assembled for each performance audit is extensive. While papers which support the audit process and report should always be retained, some of the material kept on files appeared to have limited relevance to the final outcomes and reports. *(Reference within the report on page 32)*

Performance Audit Recommendation

The Office might challenge whether all the paper collected during the course of a performance audit is necessary to support the report and whether it needs to be permanently retained.

Auditor-General's Comments

The Office will continue to determine on a case-by-case basis the level of information required to evidence audit findings. Evidence is maintained both in electronic form and paper form contained on files. Duplication is discouraged. The Office intends that electronic working papers will become the main repository of information relating to Performance Audits. Disposal of information occurs in accordance with the disposal schedule developed with the Public Records Office of Victoria and the Office will be cognisant of approaches developed through the Victorian Records Strategy relating to the protection of the electronic public record.

Committee's Comments

While the removal of clearly superfluous information from audit records is supported, due regard must also be given to the high level of information and detail required to be kept in the event of the Auditor-General's report leading to judicial enquiries, public enquiries and probity issues warranting police investigation.

2.7.3 *Size of performance audits*

Performance Auditor's Findings

Of concern in scoping audit engagements is the relative size of projects and the time and cost involved in their completion. While some subjects will always require large-scale performance audit projects, the value of outcomes available from targeted, smaller scope engagements can also be significant. The output accountability arrangements operating in the Victorian Public Sector place pressure on the Office to achieve and provide "quick wins". These need to be balanced against the objectives of the Office and the longer-term view as to how best to serve the public interest. The feedback received from surveys and interviews suggested that the above issues were not well understood by those using the reports of the Victorian Auditor-General's Office.

(Reference within the report on pages 5 and 34)

Performance Auditor's Recommendation

More emphasis needs to be given to the education of users of the Office's products and services through briefings and presentations provided by the Office, and also through explanatory material included in its plans, reports and other external publications to specifically address these issues.

Auditor-General's Comment

Agreed - a brochure which describes the process of performance audits is provided to audited agencies and other interested parties. The Office has also provided briefings to the Committee to assist in their understanding of performance audit processes and audit findings.

Committee's Comments

The Committee, while agreeing with the Performance Auditor's findings, recognises there will always be scope for large and small performance audits depending on the topic selected. The critical factor, as referred to previously by the Performance Auditor, is that greater transparency is needed as to why the Auditor-General's Office selects certain performance audit topics, compared to other potential audit topics. The Committee also supports that all key programs in Government receive adequate performance audit coverage over time, regardless of size.

2.7.4 *Communication of findings in performance audit reports*

Performance Auditor's Findings

Feedback from stakeholders suggested that performance audit reports should not only discuss issues at a high level but should also include an appropriate depth of detail to provide report users with sufficient information to take remedial action. Most performance audits deal with complex issues and subjects which can be very difficult to adequately address in a summary report form, particularly when there is also a need to keep reports concise to give them the best chance of being read. Perhaps the clearest example of this problem is the apparent trade-off between the nature of information expected by the Parliament to address accountability issues and the greater detail in reports required by an agency to allow specific concerns to be addressed and rectified. At times, this can be addressed by the use of separate reports to meet the information needs of each party.

(Reference within the report on pages 5, 34 and 35)

Performance Auditor's Recommendation

The Office should explore other avenues for communicating the findings of performance audits. These should include general and/or specific briefings for Members of Parliament, the Public Accounts and Estimates Committee, auditees and other stakeholders involved with, or interested in, the subject matter of the reports.

If separate reports are produced to meet different information needs of stakeholders, then Parliament, as the primary user of the reports, should be provided with access to the full details. The publication of a separate report in the form of a detailed 'management letter' is not acceptable unless it is also tabled or accessible by Parliament as part of the reporting process.

Auditor-General's Comments

Agreed – currently performance audit reports are provided to Members of Parliament, audited agencies, stakeholders consulted during the conduct of the audit and the general public through the Office's website. There is potential to re-assess the distribution strategy developed for each audit to better communicate the findings to a wider audience, including briefings for Parliamentarians as well as the Public Accounts and Estimates Committee and other stakeholders (including industry, professional associations and special interest groups). The Office must however be cognisant of its primary role of informing Parliament.

Committee's Comments

The Committee agrees with the Performance Auditor that there may be some merit in the Auditor-General's Office communicating the findings arising from performance audits through a briefing process. Nevertheless, attention needs to be given to the manner in which audit reports are provided to the Office's primary stakeholder, the Parliament. Reports contain executive summaries which provide an overview of findings. However, the body of the report should contain sufficient detail to enable Parliament,

through the Committee system to conduct follow-up inquiries, if warranted, to determine the extent to which Departments and Agencies address the findings in the performance audit reports. The Committee also agrees with the view of the Performance Auditor that any separate audit reports detailing matters arising from performance audits should not be provided exclusively to Agencies but should also be tabled in Parliament.

2.7.5 *Tabling of reports in Parliament*

Performance Auditor's Findings

The existing requirement to table performance audit reports only when Parliament is sitting places significant pressure on the audit process and the effectiveness of the audit outcome.

(Reference within the report on pages 5 and 35)

Performance Auditor's Recommendation

More timely provision of information to Parliament as well as more effective and efficient use of audit resources would result from the ability of the Office to table audit reports during periods when the Parliament is not in session.

Auditor-General's Comments

Agreed. The Audit (Further Amendment) Bill currently under consideration by the Parliament provides for transmission of reports of the Auditor-General to the Clerk of each House when Parliament is in recess.

Committee's Comments

The Committee strongly supports the Performance Auditor's recommendation that Auditor-General's reports should be able to be made available when Parliament is not in session. The Committee has previously recommended this on a number of occasions.

2.8 Financial statement auditing

2.8.1 *Linkage of risks with audit programs*

Performance Auditor's Findings

While the financial statement audit methodology was sound and effective, audit documentation available did not clearly link conclusions on potential risks in financial operations of a client with the subsequent extent of control testing, analytical review and detailed substantive testing that was required to be undertaken as part of the audit process conducted by staff of the Victorian Auditor-General's Office.

(Reference within the report on pages 5, 36 and 37)

Performance Auditor's Recommendation

While a risk based approach is followed, enhancements to audit documentation could be made to more clearly link conclusions on risks with decisions on the extent of control testing, analytical review and detailed substantive testing. As part of these enhancements, the potential for placing greater reliance, in certain areas, on control testing and analytical review in preference to substantive testing should be considered.

Auditor-General's Comments

Enhancements to the Office's financial audit planning methodology are in progress and will address the issues recommended.

Committee's Comments

The Performance Auditor's recommendation is sound and is being addressed by the Auditor-General.

2.8.2 *Improvement in documentation*

Performance Auditor's Findings

Although the Office demonstrates strong documentation practices, there remains further scope for improvement in these practices.
(Reference within the report on pages 5 and 37)

Performance Auditor's Recommendation

Documentation practices could be further enhanced with more detailed documentation of audit procedures conducted for:

- consideration of risk of material fraud;
- examination of non-standard journal entries and transactions;
- examination of subsequent events;
- consideration of going concern/ financial viability issues; and
- consideration of the adequacy of accounting disclosures, for example by use of compliance checklists.

Auditor-General's Comments

While audit procedures already include consideration of these issues, more specific documented guidelines for each of the areas raised will be developed and incorporated into the audit methodology utilised by Office staff.

Committee's Comments

The Performance Auditor's recommendations which have been accepted by the Auditor-General, will further improve the Office's financial statement audit methodology.

2.8.3 *Documentation of issues arising from audits*

Performance Auditor's Findings

On completion of audit testing the use of an audit findings document detailing the issues raised during the course of an audit, would further enhance the financial statement audit methodology utilised by the Office staff.
(Reference within the report on pages 5 and 37)

Performance Auditor's Recommendation

The use of an audit findings summary document would facilitate the crystallisation of issues and assist with quality assurance.

Auditor-General's Comments

An audit findings summary document is now in use and is to be enhanced for future audits as part of a review of the financial audit methodology.

Committee's Comments

The Committee supports the action taken by the Auditor-General.

2.8.4 *Attendance at Audit Committee meetings*

Performance Auditor's Findings

The Performance Auditor noted that although Financial Audit group directors attend Audit Committee meetings of their major audit clients, these meetings are not always attended by the responsible leaders from the strategic planning and sector liaison group which is responsible for monitoring risks, issues and operations across all agencies. Such joint meetings would strengthen working relationships by sharing views on sector issues and the presentation of audit plans and findings.
(Reference within the report on pages 5 and 37)

Performance Auditor's Recommendation

The Financial Audit group directors, together with relevant sector leaders, should plan to attend the Audit Committee meetings of their major audit clients at both the beginning and end of the audit process.

Auditor-General's Comments

Whether sector directors attend Audit Committee meetings with the Financial Audit directors is left to the discretion of the relevant Financial Audit directors. The adequacy of the current arrangements will be reconsidered.

Committee's Comments

The Performance Auditor's recommendation is endorsed by the Committee. Given the extensive knowledge of sector wide issues and risks held by the sector directors, benefits could be gained by sharing some of this knowledge with Audit Committees.

2.8.5 *Resolving technical issues and briefing external contractors*

Performance Auditor's Findings

An annual briefing by the Auditor-General is usually held in June (for June balance date audits) or November (for December balance date audits) for the purpose of informing audit contractors and in-house staff of audit and reporting arrangements together with anticipated issues affecting the current audit cycle. The problem arising from this arrangement is that important issues, such as the implementation of changes to accounting standards, needs to be canvassed earlier with Audit Committees to allow time for agreement with the Auditor-General as to the treatment required.

(Reference within the report on pages 5, 6, 37 and 39)

Performance Auditor's Recommendation

Audit service providers briefings need to be completed earlier, and be conducted more regularly to allow time for the issues canvassed to be raised in a timely basis at Audit Committee meetings of public sector entities.

Department of Treasury and Finance Comments

The Department agreed with the auditor's observation. The time taken, usually at the end of audits, to resolve technical accounting issues was seen as leading to excessive delays in finalising the Annual Financial Report and impacting on the ability of the Department to provide timely advice to other departments on emerging accounting policy changes prior to the finalisation of year-end financial statements.

Auditor-General's Comments

The 2001 briefing was brought forward to early June and the briefing for the 30 June 2002 year is planned for May 2002. Briefings for the December year-end audit round are conducted in November. Audit service providers are also advised to undertake their audit planning and update their knowledge of the sector and auditee, as required under Australian Auditing Standards, sufficiently in advance of year end to identify issues at Audit Committee meetings.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation. The failure to identify and address emerging issues at an early date could lead to unnecessary delays in finalising audits and subsequent delays in entities finalising their annual reports for tabling in Parliament.

2.8.6 *Compliance and probity*

Performance Auditor's Findings

The Performance Auditor considered that although contract auditors were familiar with financial statement audits, compliance and probity auditing issues were not well understood by contractors. These issues did not appear to be documented by contractors as effectively or comprehensively as they could be in comparison with financial statement audits conducted by staff of the Office. *(Reference within the report on pages 6 and 38)*

Performance Auditor's Recommendation

Investment in the development of a brief but consistent methodology to be applied to the conduct of compliance and probity audits by contractors would provide variety in the work undertaken by staff in the Financial Audits group and assist in the education of contractors.

Auditor-General's Comments

The Audit Service Providers Manual identifies the "legislative audit" mandate of the Auditor-General and the requirement to consider issues relating to compliance and probity. The manual requires auditors when planning the annual financial audit to take into account "public sector risk" and to be alert during the field work phase for matters relating to public accountability. When such matters are identified, they are to be reported to the auditee through the management letter and to the Auditor-General in the "key deliverables" submitted to the Office. Audit service providers are also required to identify two public interest issues identified during the audit process and report these to the Auditor-General at the conclusion of the audit. This could include compliance and probity issues. To ensure that these obligations are met, greater emphasis will be given to these existing requirements in future briefings to auditors.

The Office is also considering the appropriateness of developing an approach to dealing with these issues as part of its goal to provide assurance to Parliament about the integrity of public sector financial management.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation. Since up to 70 per cent of financial statement audits are undertaken by external contractors, it is important that compliance and probity issues in a public sector environment are well understood by contractors.

2.8.7 *Extended use of audit software*

Performance Auditor's Findings

The computer risk management group within the Office has access to an audit tool that enables it to provide adequate technical review support in the Unix systems environment. The Office estimates that up to 80 per cent of the financially significant applications it deals with are run within a Unix environment. However, the audit tool utilised does not address technology specific issues associated with other platforms.

(Reference within the report on page 38)

Performance Auditor's Recommendation

Some assessment should be made as to whether the IT risks at auditees, dependant upon platforms other than Unix, are being adequately addressed.

Auditor-General's Comments

Relatively few major clients use platforms other than Unix. While risks at these clients are currently assessed, the Office does not have audit software to facilitate these assessments. The

availability of appropriate software will be considered prior to the June 2002 audit cycle.

Committee's Comments

The Performance Auditor's recommendation is supported. Ideally, all major computer installations, irrespective of the platform, should be capable of being audited through the use of specialist audit software programs.

2.8.8 Computer Risk Management Group

Performance Auditor's Findings

Within the Financial Audits group is a small computer risk management team, which is predominantly involved in evaluating the computer environments of Office clients and, when requested, reviews controls within specific computer applications of clients. It is proposed that in future the team will increasingly focus on the evaluation of the more complex computer applications and emerging IT developments within Government. The Performance Auditor was of the opinion that, if this extension of their role was to occur, then there was a need for the Office to invest in more resources for the computer risk management team.

(Reference within the report on pages 6 and 38)

Performance Auditor's Recommendation

An expansion in the skill sets available to the Computer Risk Management group will be required if the Victorian Auditor-General's Office is to adequately address the emerging risks in client environments.

Auditor-General's Comments

Steps are in progress to expand the skill sets of the Computer Risk Management group through both recruitment and the engagement of external specialists for key projects.

Committee's Comments

The Committee is pleased that the Auditor-General has accepted the Performance Auditor's recommendation.

2.8.9 Computer audit software

Performance Auditor's Findings

During 2000 the Office invested in new software, Audit Command Language (ACL) for data interrogation. The Performance Auditor observed that the Financial Audits group was initially slow to use ACL. However the software was increasingly applied to the audits of Departments and major Agencies for the year ended June 2001.

(Reference within the report on page 39)

Performance Auditor's Recommendation

To further increase the use of audit software, the Computer Risk Management team should expand its advisory role to financial auditors by suggesting additional applications for ACL on particular audits and incorporating guidance within Office manuals on the benefits and uses of ACL.

Auditor-General's Comments

The Computer Risk Management group now forms part of the planning team of each major audit to assist in identifying opportunities to apply ACL and other software. In addition, the group will develop guidelines on the uses of ACL and a register of

the type of audit projects upon which the software has been effectively utilised.

Committee's Comments

Given the benefits available from the use of specialist audit software such as Audit Command Language, the Committee endorses the actions of the Auditor-General.

2.8.10 Contracted audit services

Performance Auditor's Findings

The Performance Auditor observed that the practices followed by the Auditor-General's Office for selecting, engaging, informing, managing and controlling the quality of financial statement audits performed by contracted audit service providers, are well established and managed. Nevertheless, there still remained further scope to improve the overall effectiveness of the contracted audit services. *(Reference within the report on pages 6 and 40)*

Performance Auditor's Recommendation

There are some aspects associated with contract audit activity which should be addressed:

- contract service providers should be advised of industry based issues and developments on a more frequent basis through, for example, the Office website and/or emails;
- more timely briefings to facilitate the early raising of issues with audit clients;
- increased education of contractors about probity and public interest issues;

- a perception by some contractors that the Office, in conducting quality assurance, has an unnecessarily detailed focus on financial statement disclosure which may delay the finalisation of audit reports and the subsequent issue of financial statements by agencies. (Conversely, some contractors pay inadequate attention to the quality of draft financial statements submitted for review to the Office); and
- the concern for detail and absolute conformity with reporting standards can result in unbudgeted contractor time being required to address matters not viewed by contractors as significant to the audit opinion.

Auditor-General's Comments

During 2001, the Accounting and Auditing Policy group introduced the Financial Auditing and Policy Alert Series that provides interim guidance on policy developments in relation to emerging issues. These bulletins are issued on an 'as needed' basis to provide timely guidance to contractors on significant issues.

As the auditor responsible for signing the audit report, the Auditor-General is required under the auditing standards prescribed in the Audit Act, to be satisfied about the work undertaken by audit contractors prior to signing an audit report. The Office-based quality review process, undertaken to meet that responsibility, identifies deficiencies in the financial statements or audit deliverables submitted to the Auditor-General that need to be rectified before signing. The Office regards quality and timeliness as equally important and is continually reviewing its processes to ensure it is effective and efficient.

The Auditor-General's obligations under the Audit Act are to report on whether a financial report complies with the required financial framework. In accordance with accounting and auditing standards, changes to the financial report are requested only where items are judged to be material to the financial report and are dealt with in the context of the contracted fee and the contractual obligations of the provider.

Committee's Comments

The Committee recognises the obligation of the Auditor-General to ensure that Australian Accounting and Auditing Standards are adhered to fully when undertaking his duties as outlined in the *Audit Act 1994*.

2.8.11 *Delegation of Auditor-General's authority*

Performance Auditor's Findings

The Audit Act empowers the Auditor-General to delegate to an audit contractor the power to sign the audit opinion on the financial statements of any authority where the net assets disclosed in the financial statements do not exceed a threshold amount currently set at \$1 million.
(Reference within the report on pages 6 and 41)

Performance Auditor's Recommendation

Given the large number of small, or dormant or low risk entities audited by the Office, an increase in the \$1 million net equity threshold appears warranted.

Auditor-General's Comments

Agreed. The Audit (Further Amendment) Bill, if endorsed by Parliament, will increase the delegation threshold to \$5 million expenditure.

Committee's Comments

Regardless of the threshold amount, the Auditor-General will need to exercise care in delegating his statutory responsibility to sign financial statements to private sector auditors. Quality control processes applicable to delegated audits will need to be of a high standard, particularly as there appears to be some concern about the quality of financial statement audits undertaken by some existing audit contractors, as referred to earlier in this report.

2.8.12 *Supporting documentation for delegated audits*

Performance Auditor's Findings

The Performance Auditor's review of practices adopted by the Office to manage delegated audits indicated an oversight in monitoring these arrangements. As a result, the Office had gathered insufficient supporting documentation to assess the adequacy of the opinions issued.

(Reference within the report on page 41)

Performance Auditor's Recommendation

The key issue in risk management for the Office in relation to delegated authority is the assessment of the competence of the contractor to whom the authority has been delegated. This assessment should be evidenced as part of the delegation process or established through the tender process relating to such audits.

Auditor-General's Comments

All contractors are engaged following a public tender process that involves an assessment of the competence of the contractor. The Office's quality assurance processes review the work of all contractors on a regular basis.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation. Even though the Auditor-General is able to delegate his authority to sign financial statements to private sector auditors, ultimately the responsibility and risk associated with the delegation is with the Auditor-General. It therefore remains incumbent on the Auditor-General to effectively monitor and control those delegations.

2.8.13 Thresholds applied to audit of Estimated Financial Statements

Performance Auditor's Findings

The Performance Auditor concluded that the methodology and practices followed by the Office in conducting a review of the Estimated Financial Statements, prepared by the Department of Treasury and Finance as part of the annual budget reporting process, were appropriate. Nevertheless the materiality guidelines applied by the Office in conducting the audit were considered conservative.

(Reference within the report on page 41)

Performance Auditor's Recommendation

Audit effort on the Government's Annual Financial Report might be reduced through the application of less conservative materiality thresholds.

Auditor-General's Comments

Materiality thresholds are determined annually consistent with professional auditing standards and recognise that, based on experience, the audit of certain entities (the financial results of which are taken into account in preparing the Annual Financial Report) may not be finalised at the time of signing the audit opinion on the Annual Financial Report.

Department of Treasury and Finance Comments

The Department of Treasury and Finance supports the Auditor-General's Office taking a less conservative materiality threshold to auditing the Annual Financial Report. The present policy causes significant delays in finalising the Report and often leads to cost over-runs and ultimately delays in tabling the report in Parliament.

Committee's Comments

The Committee respects the independent right of the Auditor-General to professionally determine materiality thresholds, based on risk and a range of other factors in the public sector environment which may not necessarily be present in the private sector.

2.8.14 Selection of topics for special audit review

Performance Auditor's Findings

The June 2001 Auditor-General's Report on Ministerial Portfolios in addition to highlighting issues arising from financial statement audits, published the outcome of 26 special audits across key sectors of Government. These audits, although similar in some respect to performance audits, are limited in size to a maximum of around 50 days audit time. The topic selections are approved by the Auditor-General after considering short submissions outlining objectives, issues, public benefit, scope, cost and resourcing estimates. The Performance Auditor observed in the 2001 Report that there was a variability in the significance of the issues reported.

(Reference within the report on pages 6, 42 and 43)

Performance Auditor's Recommendation

A more rigorous and transparent application of the criteria for selecting special audits is required. The reason for selecting an issue for examination and the criteria applied in making the selection should also be published in the Auditor-General's Report.

Auditor-General's Comments

The selection criteria outlined in the Office's annual plan to the Parliament is utilised for selecting all special investigations or

reviews. Consideration will be given to adopting the recommendation relating to the publication in the Report of the reason for selecting an issue for examination.

Committee's Comments

The Committee endorses the Performance Auditor's recommendation. It is important that the focus of special audits is on improving accountability and resource management in the public sector.

2.9 Managing relationships with auditees and other stakeholders

2.9.1 *Meetings with stakeholders and auditees*

Performance Auditor's Findings

Since the previous performance audit which revealed a need for increased consultation between the Office and auditees and stakeholders, there has been a significant increase in the interaction with stakeholder groups. However, the Performance Auditor indicated that this interaction has mainly been of a formal nature.

(Reference within the report on pages 7 and 44)

Performance Auditor's Recommendation

The Performance Auditor encouraged the increased use of informal meetings involving executives of the Office with auditees and other stakeholders. Such meetings produce more effective communications and reduce the reliance of the Office on survey techniques which have previously been directed significantly at measuring stakeholder and auditee satisfaction with Office outputs, rather than the relevance or effectiveness of audit outcomes.

Auditor-General's Comments

A major focus of the Office is to increase the level of liaison with auditees and other stakeholders, including face-to-face discussions with the aim of obtaining a better understanding of mutual needs and expectations.

Committee's Comments

The Committee agrees with the thrust of the Performance Auditor's recommendation to the effect that the important issue of determining the effectiveness of audit outcomes arising from reports, may be better assessed from informal meetings with stakeholders and auditees rather than through the use of survey techniques. The Committee also recognises the mutual benefits to be obtained from more informal interaction between the Office and all parties involved in the audit process.

2.9.2 *Quality of Office outputs*

Performance Auditor's Findings

The Office is re-examining its approach to managing feedback from stakeholders, including use of survey techniques, in an attempt to measure its progress in achieving Office objectives. The Performance Auditor indicated that additional strategies could be considered as part of this Office initiative.

(Reference within the report on page 44)

Performance Auditor's Recommendation

The Office was encouraged to consider the use of focus group meetings involving groups of stakeholders and report users (including Members of Parliament) to explore reactions to the strategies being considered. It was also recommended that open questions are used in Office surveys in preference to questions that prompt satisfaction ratings without qualifying comment.

Auditor-General's Comments

The Office will consider different ways of interacting with stakeholders, including face-to-face discussions to enhance the planning process. A review of the current survey design is being conducted.

Committee's Comments

The Committee notes that the Auditor-General has recognised a need for alternative communication strategies with stakeholders in order to better evaluate the extent to which these groups are satisfied with audit processes and the quality of audit reports. The Committee would expect that the review will result in a revised set of performance indicators which will more accurately reflect whether the needs and expectations of the Office's stakeholders are being met.

2.9.3 *Sharing knowledge*

Performance Auditor's Findings

As part of the corporate restructure of the Office, extensive effort has been applied to the gathering of knowledge about public sector activities to assist the Office in planning audit activities. The Performance Auditor indicated there is some scope for better utilising this large database for the benefit of the Office's clients and stakeholders.

(Reference within the report on pages 7 and 45)

Performance Auditor's Recommendation

Industry/sector experience and knowledge should be used by the Office to facilitate communication with its clients and stakeholders, including Members of Parliament, parliamentary committees, auditee executives and members of their Audit Committees. The Office should be encouraged to support its activities with regular briefings. It should also leverage from its

industry and technical strengths the ability to publish papers and articles presenting summaries and views on issues and developments which affect its stakeholders and clients.

Auditor-General's Comments

Agree. Information will continue to be used to facilitate communication with clients and other stakeholders.

Committee's Comments

The Committee supports the Performance Auditor's recommendation.

2.9.4 *Protocols between the Auditor-General's Office and the Public Accounts and Estimates Committee*

Performance Auditor's Findings

There are indications that the workloads and timeframes of the Auditor-General's Office and the Public Accounts and Estimates Committee are not as well coordinated as necessary to allow the time and resources required for consultations and exchanges between the two organisations to be effective.
(Reference within the report on pages 7 and 46)

Performance Auditor's Recommendation

There is a need to clarify and develop protocols for more effective communication, exchange of views and resource sharing between the Auditor-General, his executive team and the Public Accounts and Estimates Committee and its secretariat.

Auditor-General's Comments

The Office welcomes the opportunity to work with the Committee in the development of a wider set of protocols. The Office places a

Public Accounts and Estimates Committee

high value on its relationship with the Committee and is committed to ensuring all of its interactions are conducted in a timely and professional manner.

Committee's Comments

The Committee agrees with the Performance Auditor's recommendation.

CHAPTER 3: FREQUENCY OF PERFORMANCE AUDITS OF THE VICTORIAN AUDITOR-GENERAL'S OFFICE

The Audit Act currently provides for a performance audit of the Victorian Auditor-General's Office to be conducted at least once every three years to determine whether the Auditor-General is achieving his or her objectives effectively and doing so economically and efficiently and in compliance with the Audit Act.

In the 1998 performance audit, a recommendation was made that the period between performance audits be extended from three to five years. This recommendation was rejected by the Government.

The Performance Auditor in his 2001 report again recommended that the time between performance audits be extended from three to five years. The justification for the recommendation was that every performance audit undertaken to date had confirmed a high level of satisfaction with the performance of the Auditor-General's Office. In addition, due recognition needed to be given to the extent of the investment of time, resources and cost in the conduct of such audits.

Committee's Comments

The Committee acknowledges that each performance audit conducted since the Audit Act was amended in 1994 has reached the conclusion that the Auditor-General was achieving his objectives in compliance with the Act. Notwithstanding the overall conclusion, each performance audit has also identified areas where improvements were warranted and constructive recommendations were made as to how areas of concern could be addressed. Each performance audit has been worthwhile in terms of identifying areas for improvement, all of which have contributed to the Victorian Auditor-General's Office performing at a very high standard for the overall benefit of the Victorian community.

The Committee is also of the view that a period of five years, as recommended, is too long to wait if operational problems were to emerge and corrective action was required. It may also result in only one audit being conducted during an Auditor-General's seven year term. However, the Committee is of the view that an audit near the commencement and conclusion of an Auditor-General's term is desirable. In this context, the Committee considers that the current arrangements should continue and a performance audit of the Victorian Auditor-General's Office should be undertaken at least once in every Parliament, usually between three to four years maximum.

CHAPTER 4: APPOINTMENT OF A PERFORMANCE AUDITOR

Section 19(2) of the *Audit Act* 1994 provides that a performance audit shall be conducted by an “auditor” appointed by resolution of both Houses of Parliament, on the recommendation of the Public Accounts and Estimates Committee. To date, four performance audits of the Victorian Auditor-General’s Office have occurred, all of which were conducted by a partner from three of the top five accounting firms.

The legislation specifically refers to the appointment of an “auditor”, which is defined in the Concise Oxford Dictionary as “one who audits accounts”. By this definition, the auditor must be a qualified accountant, which has occurred with all performance auditor appointments to date.

Although all the performance audits of the Office have been of a very high standard, the Committee is concerned whether an accountant should continue to undertake what is essentially a strategic management review of the Auditor-General’s Office to determine whether the Auditor-General is achieving his objectives in an efficient, effective and economical manner and in accordance with the Audit Act. In other words, the performance audit is concerned with the accountability of the Auditor-General in relation to his responsibilities, as distinct from the accounting functions of his Office. Apart from certain aspects of the financial auditing responsibilities, which would need to be reviewed by a professional with an accounting background, the other major areas subject to examination within the Office include Office Structure and Management Practices, Corporate and Annual Planning, Performance Auditing, Corporate Governance, Information Technology Systems, Corporate Services Functions, Client Relationships, Quality of Reports and Contract Management, all of which could be examined by professionals other than those with an accounting background.

The Committee recognises the need to broaden the range of skills applied to future performance audits of the Auditor-General's Office. However from past experience, tender applications for the position are predominantly from partners employed by the major accounting firms largely because of the resources and expertise required to undertake such a high profile and complex audit. Accordingly, the Committee has had little option other than to appoint a partner from one of these firms.

The Committee is aware that there could be a potential conflict of interest in appointing a partner from an accounting firm that also derives considerable revenue from the Auditor-General's Office through contract audit services.

The dilemma is that all of the major accounting firms undertake contract audits on behalf of the Auditor-General.

From the perspective of competing accounting firms, there could also be a perception that the insight into the Auditor-General's Office gained from the performance audit, could gain a competitive advantage for the performance auditor's firm. Also, as part of the performance audit, the performance auditor has access to all contractors' records, including fees paid, by the Office.

The Committee reviewed the situation with independent external performance audits of other Audit Offices throughout Australia, New Zealand, Canada and the United Kingdom. Most other Audit Offices do not have specific legislation appointing external performance auditors. However, most Audit Offices, as a matter of good practice, have performance audits undertaken around every three years. These performance audits involve the appointment of a Chartered Accounting firm or, more commonly, a form of peer review undertaken by audit teams from other Audit Offices within Australia. The Committee does not support the concept of performance audits being undertaken by staff from other Audit Offices, despite their knowledge of public sector audit practices, on the grounds of the ongoing close relationship between the respective Offices and Auditors-General.

The Committee considers that, as the objective of the existing legislation is to provide for an independent external performance audit of the Auditor-General's Office, the process must be transparent and independent. The audit should not be undertaken by an individual associated with the Auditor-General's Office. Therefore, partners from Chartered Accounting Firms providing audit services under contract to the Auditor-General would be excluded.

The Committee acknowledges that if an academic or consultant was appointed to undertake the performance audit, they would need to include in their team a qualified accountant with a detailed knowledge of public sector auditing. Nevertheless, in terms of attracting a wider field of interest, including consulting firms, the existing legislation may need to be amended to replace the term "auditor" with a more general term. For example, under Queensland audit legislation a "strategic review" of the Queensland Audit Office must be undertaken at least every five years by "an appropriately qualified person".

Accordingly, the Committee recommends that:

Recommendation 4.1:

The Audit Act be amended to provide that the performance audit of the Victorian Auditor-General's Office be undertaken by a suitably qualified person, recommended by the Public Accounts and Estimates Committee and appointed by resolution of the Legislative Council and the Legislative Assembly.